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IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

STEVEN R. JAKUBOWSKI,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR WRIT OF CERTIORARI.

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October 14, 1998

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QUESTION PRESENTED

Whether a misrepresentation, which induces the sale of securities but does not pertain to the securities themselves or the consideration offered in exchange, is made "in connection with" that sale for purposes of establishing liability under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

TABLE OF CONTENTS

QUESTION PRESENTED i

OPINIONS BELOW 2

JURISDICTION 2

STATUTE AND RULE INVOLVED 2

STATEMENT OF THE CASE 3

A. Overview 3

B. Factual Background 5

C. Proceedings In The Court Of Appeals 7

REASONS FOR GRANTING THE WRIT 10

I. The Leading Circuits Are Sharply Divided As To Whether The "In Connection With" Requirement Mandates That A Misrepresentation Pertain To The Securities Themselves Or The Consideration Offered In Exchange 10

II. Whether The "In Connection With" Requirement Mandates That A Misrepresentation Pertain To The Securities Themselves Or The Consideration Offered In Exchange Is An Important And Recurring Issue In Need Of This Court's Immediate Review 15

III. The Seventh Circuit Wrongly Interpreted *O'Hagan* And *Naftalin* As Having Decided The Issue Left Unresolved In *Rubin* 18

CONCLUSION 19

TABLE OF AUTHORITIES

Cases:

Angelastro v. Prudential-Bache Sec., Inc., 764 F.2d 939 (3d Cir.), *cert. denied*, 474 U.S. 935 (1985) 4, 13

Bennett v. United States Trust Co. of N.Y., 770 F.2d 308 (2d Cir. 1985), *cert. denied*, 474 U.S. 1058 (1986) 16

Bernstein v. Misk, 948 F. Supp. 228 (E.D.N.Y. 1997) 14

Bissell v. Merrill Lynch & Co., Inc., 937 F. Supp. 237 (S.D.N.Y. 1996) 16

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) 9

Chemical Bank v. Arthur Andersen & Co., 726 F.2d 930 (2d Cir.), *cert. denied*, 469 U.S. 884 (1984) 3, 4, 8, 11, 12, 15, 18

Gurwara v. Lyphomed, Inc., 937 F.2d 380 (7th Cir. 1991) 4, 8, 9, 13

Hunt v. Robinson, 852 F.2d 786 (4th Cir. 1988) 3, 13, 17

Levitin v. PaineWebber, Inc., 933 F. Supp. 325 (S.D.N.Y. 1996) 16

Levitin v. PaineWebber, Inc., 1998 WL 665039 (2d Cir. Sept. 29, 1998) 16

Manela v. Garantia Banking Ltd., 5 F. Supp. 2d 165 (S.D.N.Y. 1998) 14

Prudential Ins. Co. of Am. Sales Practices Litig., 975 F. Supp. 584 (D.N.J. 1996) 13

Rubin v. United States, 449 U.S. 424 (1981) ..... *passim*

Saxe v. E.F. Hutton, Inc., 789 F.2d 105 (2d Cir. 1986) 12

SEC v. Drysdale, 785 F.2d 38 (2d Cir.), *cert. denied sub nom. Essner v. SEC*, 476 U.S. 1171 (1986) 12, 18

SEC v. Rana Research, Inc., 8 F.3d 1359 (9th Cir. 1993) 4, 13

Superintendent of Ins. of State of N.Y. v. Bankers Life & Casualty Co., 404 U.S. 6 (1971). 3, 4, 7, 10, 11, 13, 14

United States v. Naftalin, 441 U.S. 768 (1979) 4, 7, 9, 11, 13, 17, 18

United States v. O'Hagan, -- U.S. --, 117 S. Ct. 2199 (1997) 4, 7, 9, 13, 15, 17, 18

***Statutes and Regulations*:**

15 U.S.C. § 78j(b) ("Section 10(b)") ..... *passim*

15 U.S.C. § 77q(a)(1) ("Section 17(a)") 8, 11, 18

28 U.S.C. § 1254(1) 2

17 C.F.R. § 240.10b-5 ("Rule 10b-5") ..... *passim*

***Other Authorities*:**

8 Louis Loss & Joel Seligman, Securities Regulation 3680-82, 3686 (3d ed. 1991) 3, 11

Brief of the SEC, Amicus Curiae, in *Levitin*, *reprinted in* The SEC Speaks in 1997, 980 PLI Corp. 269 (Barry P. Barbash & William R. McLucas eds. 1997) 16

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ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR WRIT OF CERTIORARI.

Petitioner Steven R. Jakubowski ("Petitioner" or "Jakubowski") respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 71a-86a)[1] is reported at 150 F.3d 675. The opinion of the district court in denying Petitioner's motion to dismiss (App., *infra*, 1a-32a) is reported at 912 F. Supp. 1073. Further appended to this petition are the additional unreported opinions and orders of the district court (i) granting the motion of the Securities and Exchange Commission ("SEC" or "Respondent") for summary judgment and denying Petitioner's motion for summary judgment (App., *infra*, 33a-57a), (ii) granting in part and denying in part Respondent's request for permanent injunctive relief, disgorgement, prejudgment interest, and a civil penalty (App., *infra*, 58a-66a), and (iii) entering final judgment against Petitioner (App., *infra*, 67a-70a).

JURISDICTION

The judgment of the court of appeals was entered on July 16, 1998. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTE AND RULE INVOLVED

The texts of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) ("Section 10(b)"), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5 ("Rule 10b-5"), are reproduced at App., *infra*, 87a-88a.

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[1] "App." refers to the appendix bound to this petition.

STATEMENT OF THE CASE

A. *Overview*

The federal securities anti-fraud provisions of Section 10(b) and Rule 10b-5 expressly provide that material misrepresentations or omissions are actionable if made "in connection with" the purchase or sale of a security. Determining the scope of the "in connection with" requirement of Section 10(b) and Rule 10b-5 is critical because, as one leading treatise explains, it "concerns when federal jurisdiction is appropriate" and "serves an important filtration function." 8 Loss & Seligman, Securities Regulation 3686 (3d ed. 1991).

Justice Douglas's use of the term "touching" in *Superintendent of Ins. of State of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12-13 (1971), was this Court's first direct reference to this important jurisdictional limitation. In *Rubin v. United States*, 449 U.S. 424 (1981), the Court left unresolved the question of whether the anti-fraud provisions of the federal securities laws make actionable only those misrepresentations or omissions that pertain to the securities themselves. *Id.* at 429 n.6.

In *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930 (2d Cir.), *cert. denied*, 469 U.S. 884 (1984), Judge Friendly answered the question left unresolved by *Rubin*, holding that the alleged fraud must pertain to the securities themselves or the consideration offered in exchange to be actionable under Section 10(b) and Rule 10b-5. *Id.* at 943. This remains the rule of law in the Second Circuit. It also has been adopted by the Fourth Circuit. *See Hunt v. Robinson*, 852 F.2d 786 (4th Cir. 1988).

The rule of *Chemical Bank*, however, is not the law in the Third or Ninth Circuits. Relying upon Justice Douglas's use of the term "touching" in *Superintendent of Insurance*, these circuits only require proof of some causal connection or nexus between the alleged fraud and the securities transaction to satisfy the "in connection with" requirement of Section 10(b) and Rule 10b-5. *See, e.g., Angelastro v. Prudential-Bache Sec., Inc.*, 764 F.2d 939 (3d Cir.), *cert. denied*, 474 U.S. 935 (1985); *SEC v. Rana Research, Inc.*, 8 F.3d 1358 (9th Cir. 1993).

Before this case was decided, it was presumed that the Seventh Circuit followed the Second Circuit. *See Gurwara v. Lyphomed, Inc.*, 937 F.2d 380 (7th Cir. 1991). Relying upon this Court's decisions in *United States v. O'Hagan*, -- U.S. --, 117 S. Ct. 2199 (1997) and *United States v. Naftalin*, 441 U.S. 768 (1979), however, Judge Easterbrook swept away the general principles for which *Gurwara* had seemingly stood. App., *infra*, 77a-82a. The resultant rule in the Seventh Circuit is equivalent to the rule adopted by the Third and Ninth Circuits.

In this case, there is no dispute that the misrepresentation at issue went only to the identity of the purchaser of the securities and not to the securities themselves or the consideration offered in exchange. App., *infra*, 21a, 48a, 80a-82a. As such, this case squarely presents the question left unresolved in *Rubin*, a question that deeply divides the circuits.

B. *Factual Background*

During 1991 and 1992, four midwest-based savings and loan associations (collectively, the "Converting Thrifts") announced to the public their plans to convert from a mutual to stock form of ownership, subject to the rules promulgated by the Office of Thrift Supervision ("OTS"). App., *infra*, 34a-35a. Once the plan of conversion was approved by the OTS, each of the Converting Thrifts would prepare and distribute a prospectus that offered the stock for sale. *Id.*, 76a.

Each of the preprinted stock order forms that accompanied the prospectus set forth in bold the predetermined price per conversion share and left a blank space for the number of shares sought to be purchased by the subscribing shareholder. App., *infra*, 35a, 75a. The stock order forms further contained a preprinted representation by the subscribing shareholder that "there is no agreement or understanding regarding the transfer of my subscription rights or any further sale or transfer of these shares." App., *infra*, 35a-38a, 76a-77a. The stock order form's preprinted representation was derived directly from certain OTS regulations that required Converting Thrifts to give their long-standing depositors ("Qualified Account Holders") nontransferable priority subscription rights to purchase the stock of the Converting Thrifts in the offering. App., *infra*, 34a.

The general public could participate in the conversion offering only after all the subscription requests of Qualified Account Holders were honored. App., *infra*, 34a. Because Qualified Account Holders in the conversions in which Jakubowski participated subscribed for more shares than were available for sale, the lower priority subscription orders

submitted by the general public went unfilled. App., *infra*, 51a, 79a.

Between May 1991 and March 1992, Frank E. Hart ("Hart") and his venture capital affiliate, Generation Capital Associates ("GCA"), purchased shares of conversion stock using the nontransferable subscription rights granted by the Converting Thrifts to Qualified Account Holders. App., *infra*, 75a-77a. Jakubowski enabled Hart and GCA to purchase these conversion shares by finding Qualified Account Holders willing to submit stock purchase orders on behalf of Hart and GCA, filling out the order forms to purchase the conversion stock, procuring the signatures of the Qualified Account Holders through whom the stock purchase orders were submitted, and adding his own name on the form as the person to whom the stock should be delivered when issued. App., *infra*, 75a-77a. Hart would then cause the shares to be sold in the market soon after public trading in the stock commenced. *Id.* Profits were split among Hart, Jakubowski, and the account holder. *Id.* Jakubowski's total share of the profits from the sale of the conversion stock in the public markets was $51,500. App., *infra*, 69a.

On October 12, 1994, the SEC filed a one-count civil complaint against Jakubowski alleging violations of Section 10(b) and Rule 10b-5 arising from Jakubowski's participation in the conversion transactions. Jakubowski moved to dismiss. The district court denied the motion App. *infra* 1a-32a.. In concluding that Jakubowski's misstatement regarding the true identity of the purchaser satisfied the "in connection with" requirement of Section 10(b) and Rule 10b-5, the district court relied upon Justice Douglas's use of the word "touching" in *Superintendent of Ins. of State of N.Y. v.*

Bankers Life & Casualty Co., 404 U.S. 6, 12-13 (1971). App., *infra*, 26a. The misstatement "touched" the sale of the conversion stock, the district court reasoned, because it was the "means of accomplishing the purchase of securities." *Id.*.

On March 31, 1997, the district court granted the SEC's motion for summary judgment and reaffirmed without additional review its earlier views regarding the scope of the "in connection with" requirement of Section 10(b) and Rule 10b-5. App., *infra*, 52a. On October 2, 1997, the district court entered final judgment of permanent injunction and ordered Jakubowski to turn over to the SEC $51,500 in profits, an equal amount in statutory civil penalties, and prejudgment interest. App., *infra*, 67a-70a.

C. *Proceedings In The Court Of Appeals*

In a decision entered July 16, 1998, the Seventh Circuit affirmed the holding of the district court. Relying upon this Court's decisions in *United States v. O'Hagan*, -- U.S. --, 117 S. Ct. 2199 (1997) and *United States v. Naftalin*, 441 U.S. 768 (1979), the Seventh Circuit held that misrepresentations need not pertain to the securities themselves (or, more specifically, to their value) in order to satisfy the "in connection with" requirement of Section 10(b) and Rule 10b-5. App., *infra*, 79a-82a. It was enough, the court held, that the misstatements were made directly to the issuer of the securities in order to induce the issuer to accept the subscription orders. App., *infra*, 78a.

In reaching this result, Judge Easterbrook rejected as dicta a rule announced in *Gurwara v. Lyphomed, Inc.*, 937 F.2d

380 (7th Cir. 1991). There, the Seventh Circuit dismissed a Section 10(b) case because the "misrepresentation went only to Gurwara's opportunity to purchase the stock at the described price . . . [and not] . . . to the value of the stock at issue or the value of the consideration in return for it." *Id.* at 383. Notably, the *Gurwara* court closely adhered to the Second Circuit's ruling in *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 943 (2d Cir.), *cert. denied*, 469 U.S. 884 (1984), the seminal post-*Rubin* case addressing the "in connection with" requirement, in which Judge Friendly wrote:

> In *Rubin*, the Supreme Court stated that it "need not decide whether misrepresentations or omissions involved in a securities transaction but not pertaining to the securities themselves can form the basis of a violation of Sec. 17(a)." We are here compelled to decide that question, with respect to Sec. 10(b) and Rule 10b-5 as well as Sec 17(a); our answer is negative.

Chemical Bank, 726 F.2d at 943.

After posing the identical question left unresolved in *Rubin*, the *Gurwara* court embraced the Second Circuit's rule of law, stating:

> We see no reason to differ with [the Second or Fourth Circuits] or their analysis on the facts before us. . . . [T]here is no reason to believe that this was the type of misrepresentation Congress meant to proscribe through the federal securities laws. . . . [T]he misrepresenta-

> tions did not go to the value of the stock at issue or the value of the consideration in return for it.

Gurwara, 937 F.2d at 383.

Relying upon this Court's holding in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), the Seventh Circuit dismissed these statements of law as mere dicta. *Id.* As regards the question left unresolved in *Rubin*, Judge Easterbrook declared that the answer is found in *O'Hagan* and *Naftalin* (which preceded *Rubin*). *Id.* If a misrepresentation must concern the value of the security in order to meet the "in connection with" requirement, Judge Easterbrook wrote, then *O'Hagan* and *Naftalin* were wrongly decided. *Id.* The frauds perpetrated in those cases, he claimed, did not pertain to the securities themselves (or, more specifically, to their value), yet were actionable under Section 10(b) and Rule 10b-5. *Id.* The Seventh Circuit concluded that the requirements of Section 10(b) and Rule 10b-5 had been met and affirmed the ruling of the district court. App., *infra*, 77a-86a.

REASONS FOR GRANTING THE WRIT

The Court needs to resolve whether a misrepresentation or omission that induces the sale of securities but does not pertain to the securities themselves or the consideration offered in exchange is made "in connection with" that sale for purposes of establishing liability under Section 10(b) and Rule 10b-5. The present conflict among the leading circuits in this area is long-standing, and the passage of additional time is unlikely to resolve the sharply contrasting views. The question also has enormous practical significance and is squarely presented by this case. The petition, therefore, should be granted.

I. THE LEADING CIRCUITS ARE SHARPLY DIVIDED AS TO WHETHER THE "IN CONNECTION WITH" REQUIREMENT MANDATES THAT A MISREPRESENTATION PERTAIN TO THE SECURITIES THEMSELVES OR THE CONSIDERATION OFFERED IN EXCHANGE.

Both Section 10(b) and Rule 10b-5 require that any misstatement or omission of a material fact be made "in connection with" the purchase or sale of a security. App., *infra*, 87a-88a. In *Superintendent of Ins. of State of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12-13 (1971), this Court noted that the requirements of Section 10(b) and Rule 10b-5 had been satisfied where the plaintiff "suffered an injury as a result of deceptive practices touching its sale of securities as an investor." In commenting upon this case, one leading commentator observed: "there is no reason to believe that Justice Douglas's use of 'touching' was anything more than his variation of 'in connection with' as a matter of literary

style." 8 Louis Loss & Joel Seligman, Securities Regulation 3681-82 (3d ed. 1991).

This Court next addressed the "in connection with" requirement in *United States v. Naftalin*, 441 U.S. 768 (1979), noting in a footnote that the Court in *Superintendent of Insurance* used the terms "in" and "in connection with" interchangeably. *Id.* at 773 n.4. Two years later, in *Rubin v. United States*, 449 U.S. 424 (1981), this Court expressly reserved for another day the question of "whether misrepresentations or omissions involved in a securities transaction but not pertaining to the securities themselves can form the basis of a violation of § 17(a) [of the Securities Act of 1933]."[2] *Id.* at 429 n.6. The Court has not addressed this issue again since *Rubin*.

As noted above (*supra*, at 8), the Second Circuit in *Chemical Bank* felt "compelled to decide," in the negative, the question posed by *Rubin*. *Chemical Bank*, 726 F.2d at 943. In concluding that misrepresentations or omissions must pertain to the securities themselves in order to satisfy the "in connection with" requirement of Section 10(b) and Rule 10b-5, Judge Friendly reasoned:

> The purpose of Sec. 10(b) and Rule 10b-5 is to protect persons who are deceived in securities transactions — to make sure that buy-

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[2] Section 10(b) is often considered the statutory equivalent under the Securities Exchange Act of 1934 of Section 17(a) under the Securities Act of 1933 ("Section 17(a)"). *See Chemical Bank*, 726 F.2d at 942 ("Section 10(b) . . . was obviously drawn from Sec. 17(a) of the 1933 Act") (*citing Naftalin*).

> ers of securities get what they think they are getting and that sellers of securities are not tricked into parting with something for a price known to the buyer to be inadequate or for a consideration known to the buyer not to be what it purports to be.

Id.

The Second Circuit addressed the issue again in *Saxe v. E.F. Hutton, Inc.*, 789 F.2d 105 (2d Cir. 1986), where it dismissed plaintiff's Section 10(b) claim because the alleged misrepresentations did not "concern[ ] the value of the securities he sold or the consideration he received in return." *Id.* at 108. "In this regard," the court stated, "our holding in [*Chemical Bank*] is controlling." *Id.*

The SEC has argued that broad application of the "in connection with" requirement is consistent with the Second Circuit's decision in *SEC v. Drysdale*, 785 F.2d 38 (2d Cir.), *cert. denied sub nom. Essner v. SEC*, 476 U.S. 1171 (1986). It is true that in *Drysdale* the Second Circuit distinguished *Chemical Bank* on the basis that "the securities were transferred as a direct result of a misrepresentation, whereas in *Chemical Bank* the direct result of the misrepresentations was a loan and not a securities transfer." *Drysdale*, 785 F.2d at 43. The SEC, however, overstates *Drysdale's* importance. *Drysdale* was decided first and foremost on the ground that the "misrepresentation clearly pertained to a significant part of the consideration offered." *Id.* at 42.

As such, *Drysdale* and *Chemical Bank* articulated a two-prong test that must be met to satisfy the "in connection

with" requirement of Section 10(b) and Rule 10b-5: first, the fraud must pertain to the securities themselves or the consideration offered in exchange; second, the fraud must have induced the securities transaction. *Id.* at 42-43. Conversely, meeting only the second of these two prongs will not satisfy the "in connection with" requirement of Section 10(b) and Rule 10b-5. *Id.* This approach was adopted by the Fourth Circuit in *Hunt v. Robinson*, 852 F.2d 786 (4th Cir. 1988).

The approach of the Second and Fourth Circuits to the "in connection with" requirement is not the approach adopted by the Third and Ninth Circuits. These circuits have construed this Court's use of the term "touching" in *Superintendent of Insurance* as requiring only proof of some causal connection or nexus between the alleged fraud and the securities transaction. *See Angelastro v. Prudential-Bache Sec., Inc.*, 764 F.2d 939, 943 (3d Cir.), *cert. denied*, 474 U.S. 935 (1985) ("touching" requirement only mandates that there be some causal connection between the alleged fraud and the purchase or sale of a security); *SEC v. Rana Research, Inc.*, 8 F.3d 1359, 1362 (9th Cir. 1993) ("in connection with" requirement is satisfied "if the fraud alleged 'somehow touches upon' or has 'some nexus' with 'any securities transaction'"). *Cf. Prudential Ins. Co. of Am. Sales Practices Litig.*, 975 F. Supp. 584, 607-608 (D.N.J. 1996) (interpreting the law in the Third Circuit as different from the law in the Second, Fourth, and — based on *Gurwara* — Seventh Circuits).

In this case, the Seventh Circuit changed direction and implicitly rejected the Second Circuit's narrower construction of the "in connection with" requirement. As discussed in Section III below (*infra*, at 17-18), however, the Seventh Circuit's shift in position is premised upon a flawed reading

of this Court's rulings in *O'Hagan* and *Naftalin*, both of which involved deceptive conduct that pertained to the securities themselves or the consideration offered in exchange.

The deep rift among the circuits, and resultant inconsistency of rulings among them, is especially evident in this case. Recent district court cases in the Second Circuit have held that misrepresentations or omissions about the identity, background, or qualifications of a party to a securities transaction that were unrelated to the securities themselves or the consideration offered in exchange failed to satisfy the "in connection with" requirement of Section 10(b) and Rule 10b-5. *See Manela v. Garantia Banking Ltd.*, 5 F. Supp. 2d 165, 175 (S.D.N.Y. 1998) (failure to disclose identity of seller was not relevant to the value of the securities or the consideration paid, and thus not "in connection with" purchase or sale of securities); *Bernstein v. Misk*, 948 F. Supp. 228, 243 (E.D.N.Y. 1997) (misrepresentations of defendants' own financial positions and omissions concerning backgrounds and intentions "do not in any way implicate the characteristics or attributes of the [securities] and hence were not made `in connection with' the purchase and sale of securities"; *Abrash v. Fox*, 805 F. Supp. 206, 208 (S.D.N.Y. 1992) (dismissing case against lawyer who misrepresented his own qualifications and intentions on basis that "even when there is a clear causal connection between the misrepresentations and the investment decision, there is no securities law violation unless the misrepresentations or omissions pertain to the securities themselves"). Those cases, however, would likely have survived motions to dismiss in the Third, Seventh, and Ninth Circuits because the misrepresentations or omissions in all cases allegedly induced a transaction in securities.

Nearly 27 years have passed since Justice Douglas's off-hand use of the word "touching" in *Superintendent of Insurance*. Nearly 18 years have passed since the Court in *Rubin* left unresolved the question of whether the "in connection with" requirement mandates that the misrepresentations or omissions in question pertain to the securities themselves. *O'Hagan* did not address the issue because in that case the deceptive conduct pertained to the price of the securities themselves. *See*, *infra*, at 17-18. The circuit courts remain deeply divided on this issue, with the Second and Fourth Circuits answering "yes" to the question left open in *Rubin* and the Third, Ninth, and (by this case) Seventh Circuits answering "no." By implicitly rejecting the rule and reasoning of *Chemical Bank*, the Seventh Circuit did not redraw the battle lines, it merely crossed them. Additional reflection by the lower courts will not reconcile these conflicting views. As such, the Court should grant this petition and resolve once and for all the question left open in *Rubin*.

II. Whether the "In Connection With" Requirement Mandates That a Misrepresentation Pertain to the Securities Themselves or the Consideration Offered in Exchange Is an Important and Recurring Issue in Need of This Court's Immediate Review.

Several other compelling policy concerns justify granting this petition for a writ of certiorari.

1. To the SEC, this case represents an important victory in its effort to cause all circuits to adopt the broader construction of the "in connection with" requirement. Indeed,

the issue is so important to the SEC that it felt compelled to intervene, as *amicus curiae*, in two Second Circuit disputes between private litigants solely to advocate that *Chemical Bank's* narrowing of the "in connection with" requirement should be rejected.[3] *See* Brief of the SEC, Amicus Curiae, *reprinted in* The SEC Speaks in 1997, 980 PLI Corp. 269 (Barry P. Barbash & William R. McLucas eds. 1997).

The Second Circuit in the *Levitin* case recently affirmed the lower court's dismissal of the case, but solely on the alternative ground of lack of materiality. *Levitin v. Paine Webber, Inc.*, 1998 WL 665039 (2d Cir. Sept. 29, 1998). Notably, the Second Circuit never even addressed the "in connection with" requirement or the arguments advanced by the SEC in its *amicus curiae* brief. Given the similar fact patterns in *Levitin* and *Bissell*, the Second Circuit likely again will avoid the issue entirely in *Bissell*.

2. This case has the distinct advantage of squarely presenting the issue left unresolved by this Court in *Rubin*. Indeed, it is hard to imagine a fact pattern that presents the issue as starkly as this case does. This case, for example, is not a dispute among only private litigants. Thus, it does not require this Court to separate the "in connection with" requirement from the interrelated concepts of "transaction causation" and "loss causation." *See, e.g., Bennett v. United States Trust Co. of N.Y.*, 770 F.2d 308, 313 (2d Cir. 1985), *cert. denied*, 474 U.S. 1058 (1986). Further, both the district court and the Seventh Circuit agreed that the misrepresenta-

[3] The appeals in which the SEC appeared as *amicus curiae* were of decisions in *Levitin v. PaineWebber, Inc.*, 933 F. Supp. 325 (S.D.N.Y. 1996), and *Bissell v. Merrill Lynch & Co., Inc.*, 937 F. Supp. 237 (S.D.N.Y. 1996).

tion as to the true identity of the purchaser of the Converting Thrifts' stock did not pertain to the securities themselves or to the consideration offered in exchange. App., *infra*, 4a-5a, 21q, 48a, 80a-82a..

3. With a number of global securities markets in substantial turmoil and suffering from precipitous declines, suits alleging federal securities fraud under Section 10(b) and Rule 10b-5 can be expected to rise dramatically. In many of these cases, the federal securities fraud action provides the sole jurisdictional hook for a plaintiff to bring into federal court a host of state law fraud claims. *See, e.g., Hunt*, 852 F.2d at 787 (notes in dismissing case that seven of plaintiff's eight causes of action are cognizable under state law). Lower courts need guidance on the scope of the "in connection with" requirement so they can act with certainty as to whether federal jurisdiction should be exercised over a case that otherwise belongs in state court.

4. In light of the presence of many securities industry participants in multiple jurisdictions across the country, the absence of uniformity among the circuits will surely promote undue forum shopping. Securities fraud plaintiffs alleging misrepresentations or omissions unrelated to the securities themselves or the consideration offered in exchange would be hard pressed to commence an action in the Second or Fourth Circuits when suit against the same defendant in the Third, Seventh, or Ninth Circuits would likely survive a motion to dismiss.

III. THE SEVENTH CIRCUIT WRONGLY INTERPRETED *O'HAGAN* AND *NAFTALIN* AS HAVING DECIDED THE ISSUE LEFT UNRESOLVED IN *RUBIN*.

Central to the Seventh Circuit's ruling were this Court's decisions in *O'Hagan* and *Naftalin*. App., *infra*, 79a-82a. The misrepresentations or deceptions at issue in both cases, however, pertained to the securities themselves or the consideration offered in exchange. As such, neither case answers the question left open in *Rubin*.

As the Court stressed in *O'Hagan*, the misappropriation theory, like its complement — the "traditional" or "classical" theory of insider trading, addresses efforts to "capitalize on non-public information through the purchase or sale of securities." *O'Hagan*, 117 S. Ct. at 2207. At root, these complementary theories are designed to "protect the integrity of the securities markets against abuses by [persons] who have access to confidential information that will affect the corporation's security *price* when revealed." *Id.* (emphasis added). Accordingly, these activities are actionable, even under the rule of *Chemical Bank*, because they directly relate to the price of the securities.

The Seventh Circuit also misreads *Naftalin*. Had this Court's view of the scope of the "in connection with" requirement been settled by *Naftalin* (at least with respect to Section 17(a)), it is unlikely that the Court in *Rubin* only two years later would have reserved the precise question that the Seventh Circuit asserts was resolved in *Naftalin*. Moreover, as noted by the Second Circuit in *Drysdale*, a case the Second Circuit said closely resembled *Naftalin*, the misrepresentations in *Naftalin* were actionable because they pertained

to a significant part of the consideration offered in exchange. *Drysdale*, 785 F.2d at 42.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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October 14, 1998

TABLE OF APPENDICES.

APPENDIX A

Memorandum, Opinion and Order of the District Court for the Northern District of Illinois denying Petitioner's motion to dismiss, dated January 2, 1996 ..... 1a

APPENDIX B

Memorandum, Opinion and Order of the District Court for the Northern District of Illinois granting Respondent's motion for summary judgment and denying Petitioner's motion for summary judgment, dated March 31, 1997 ..... 33a

APPENDIX C

Memorandum, Opinion and Order of the District Court for the Northern District of Illinois granting in part and denying in part Respondent's request for permanent injunctive relief, disgorgement, and prejudgment interest, and a civil penalty, dated September 12, 1997 ..... 58a

APPENDIX D

Final judgment of permanent injunction and other relief against Steve R. Jakubowski 67a

APPENDIX E

Decision of the United States Court of Appeals for the Seventh Circuit, dated July 16, 1998 ..... 71a

APPENDIX F

Section 10(b) of the securities exchange act of 1934 ..... 87a

APPENDIX G

Rule 10b-5 of the securities and exchange commission 88a

APPENDIX A.

* 1073 912 F. Supp. 1073

Fed. Sec. L. Rep. P 99,103

SECURITIES AND EXCHANGE COMMISSION, Plaintiff,

v.

Steven R. JAKUBOWSKI, Defendant.

No. 94 C 4539.
United States District Court,
N.D. Illinois,
Eastern Division.

Jan. 2, 1996.

Securities and Exchange Commission brought securities fraud case against attorney. Attorney moved to dismiss. The District Court, Ann Claire Williams, J., held that security fraud claim was stated against attorney, for allegedly participating in scheme involving inducement of financial institutions, converting from mutual to stock ownership, to sell stock set aside for purchase by account holders to member of general public, prior to date when public sale was authorized, by falsely indicating that stock was being purchased by an account holder.

Motion denied.

*1076 Robert J. Burson, Securities & Exchange Commission, Chicago, IL, Nancy J. Guarino, United States Securities

& Exchange Commission, Chicago, IL, for Securities and Exchange Commission.

Christopher James Barber, Christopher C. Kendall, Coffield, Ungaretti and Harris, Chicago, IL, for Steven R. Jakubowski.

MEMORANDUM OPINION AND ORDER

ANN CLAIRE WILLIAMS, District Judge.

Defendant Steven R. Jakubowski moves the court to dismiss Plaintiff Securities and Exchange Commission's complaint against him pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. For the reasons set forth below, the court denies Jakubowski's motion.

Background

For the purposes of this motion to dismiss, the Court accepts the following facts as true. At all times relevant to this case, Defendant Steven R. Jakubowski was an attorney at a law firm in Chicago. (Complaint ¶ 8.)[1] Frank Hart was president of Generation Capital Associates ("GCA"), a venture capital firm headquartered in New York. (Complaint ¶ 11.)

In April, 1991, Cragin Financial Corporation ("Cragin Corp."), the holding company for Cragin Federal Bank for Savings ('Cragin Bank"), announced that Cragin Bank would

[1] Throughout this Memorandum Opinion the term "Complaint" refers to the Commission's Amended Complaint for Permanent Injunction and Other Relief.

convert from mutual to stock ownership[2] and would offer 10,500,000 shares of ***1077** common stock ("Cragin stock") for sale at approximately $10 per share. Eligible Cragin Bank accountholders received non-transferable Conversion Subscription Rights ("conversion rights'), giving them a preferential opportunity to purchase Cragin stock before it went on sale to the general public. Accountholders who wished to purchase stock had to exercise their conversion rights no later than May 25, 1991. (Complaint ¶ 10.)

Approximately five days before the Cragin subscription offering closed, Hart and Jakubowski formed a plan to buy Cragin stock using the conversion rights given to valid Cragin accountholders. Jakubowski, Hart, and GCA were not eligible Cragin accountholders at the time of the subscription offering, and were therefore not personally eligible for conversion rights. (Complaint ¶ 11.)

Jakubowski located a secretary in the law firm where he worked who was an eligible Cragin accountholder. He explained to the secretary that he wanted to use her conversion rights to buy Cragin stock on behalf of an unnamed individual. He further explained that she would incur no risk in the transaction, and would receive a percentage of any profit made on the sale of the stock. (Complaint ¶ 13.) The secre-

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[2] Savings associations can be either mutual or stock institutions. In accordance with federal law, mutual institutions may convert to stock institutions by issuing and selling shares of "conversion stock." Any such conversion is regulated by the Office of Thrift Supervision ("OTS"). OTS Regulation 12 CFR § 563b.3(c) requires that a converting savings institution give eligible accountholders subscription rights, which allow them to purchase certain amounts of the institution's conversion stock before the general public may do so.

tary agreed to participate, and shortly thereafter Jakubowski filled out a Stock Order Form for 35,000 shares of Cragin stock. (Complaint ¶ 14.) This stock order form contained language directly above the signature line that stated: "All rights exercisable hereunder are not transferable and shares purchased upon exercise of such right must be purchased for the account of the person exercising such rights. "Although the stock order form listed the secretary as the actual purchaser of the stock, Jakubowski indicated that the stock was to be sent directly to him at the law firm. The secretary signed the form, and Jakubowski took the form to Cragin on May 25, 1991. (Complaint ¶ 14.) At no time before the conversion did Cragin learn that Jakubowski, Hart and GCA were using the valid accountholder's Conversion Subscription Rights so that Hart and GCA could buy the stock themselves. (Complaint ¶ 18.)

Jakabowski further instructed the secretary to turn control of the Cragin Stock over to GCA and Hart by signing a blank stock power form. He sent a copy of the form to Hart who then wired $350,000 to Cragin to pay for the stock ordered in the secretary's name. (Complaint ¶ 15.) Jakubowski prepared an agreement between Hart and the secretary formalizing their understanding that the secretary would receive a fixed percentage of any profits made on the sale of the Cragin stock. (Complaint ¶ 16.)

Cragin made the conversion from mutual to stock ownership on June 6, 1991. (Complaint ¶ 17.) Cragin Stock was oversubscribed, and therefore some accountholders were not able to buy any Cragin Stock and others could only buy a portion of what they had requested. However, GCA and Hart did buy the entire 35,000 shares they had ordered at $10 per

share. In contrast, the members of the general public who did not have conversion rights were not able to purchase any shares in the initial offering, and instead had to buy the stock when it opened for public trading at $13.50 per share. (Complaint ¶ 17.) When Jakubowski received the stock certificate from Cragin, he forwarded it to Hart, who sold the stock for a profit. Pursuant to their earlier agreement, Hart gave Jakubowski approximately $10,000 for his participation in the plan. (Complaint ¶ 20.)

Several months later, Calumet Federal Savings and Loan Association of Chicago ("Calumet") announced that it would be converting to a stock form of ownership, and in conjunction with this conversion would be offering 2,050,000 shares of stock ("Calumet stock") to eligible accountholders at approximately $15 per share. Eligible accountholders had until February 6, 1992 to exercise their Conversion Subscription Rights. (Complaint ¶ 19.) While neither Jakubowski, nor Hart, nor GCA was a Calumet accountholder, ***1078** Jakubowski was able to find the father of a secretary at his firm who was an eligible accountholder. (Complaint pp 20, 21.)

Jakubowski had the accountholder sign a stock order form which Jakubowski then completed and submitted to Calumet's holding company. (Complaint ¶ 21.) This stock order form contained language specifying that:

> All rights exercisable hereunder are not transferable and shares purchased upon exercise of such rights must be purchased for the account of the person exercising such rights. The undersigned certifies that the Stock Order is for my account only and there is no agreement or under-

> standing regarding the transfer of my subscription rights or any further sale or transfer of these shares.

(Complaint ¶ 21.) Jakubowski again prepared a written agreement between Hart and GCA and the secretary's father promising that the father would get a certain percentage of any profits on the sale of the Calumet stock. (Complaint ¶ 22.) Calumet did not become aware that GCA and Hart were the true purchasers of the stock until after the conversion (Complaint ¶ 24.)

The Calumet Stock was oversubscribed, and consequently, some accountholders did not get a chance to purchase the stock they had ordered, and no non-accountholders were legally able to buy any stock until after trading began. (Complaint ¶ 23.) GCA and Hart, by using the secretary's father's conversion rights did receive all of its requested shares at $15 per share. (Complaint ¶ 23.) GCA and Hart later sold those shares at a profit and provided Jakubowski with a $5,000 share (Complaint ¶ 24.)

In addition to the preceding transactions, Jakubowski, Hart and GCA participated in similar plans when AmeriFed Financial Corporation ("AmeriFed") and Plains Spirit Financial Corporation ("Plains Spirit") converted to stock ownership. (Complaint 1 25.) In the case of the AmeriFed transaction, Jakubowski personally borrowed money from Hart so that he could purchase stock for himself by using a valid accountholder's Conversion Subscription Rights, (Complaint ¶ 25.) As in the Cragin and Calumet transactions, Jakubowski completed stock order forms signed by the eligible accountholders so that he, Hart or GCA could purchase conversion stock. (Complaint ¶ 26.) Both the AmeriFed and the Plains

Spirit offerings were also oversubscribed, resulting in a shortage of stock for the accountholders.

In total, Jakubowski used accountholder's Conversion Subscription Rights to purchase approximately 172,050 shares of Conversion Stock for himself, Hart and GCA for a total price of nearly $2 million. (Complaint ¶ 27.) Jakubowski himself made at least $49,500 as the result of his participation in the plans. (Complaint ¶ 28.)

Analysis

Jakubowski moves the court to dismiss the complaint against him pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure for failure to state a claim upon which relief can be granted. The court will dismiss a complaint for failure to state a claim only where "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Chaney v. Suburban Bus Div.*, 52 F. 3d 623, 627 (7th Cir. 1995) (quoting *Conley v. Gibson*, 355 U.S. 41, 45-46, 78 S.Ct. 99, 101-02, 2 L.Ed.2d 80 (1957)). In deciding whether the complaint states a claim, the court "accept[s] as true the factual allegations of the complaint and draw[s] all reasonable inferences in favor of the plaintiff[ ]." *Lashbrook v. Oerkfitz*, 65 F.3d 1339, 1343 (7th Cir.1995) (citing *Znermon v. Burch*, 494 U.S. 113, 118, 110 S.Ct. 975, 979, 108 L.Ed.2d 100 (1990)).

[1] In its Amended Complaint the Securities and Exchange Commission ("the Commission") alleges that Jakubowski violated Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 USC § 78j, as well as Rule 10b-5 promulgated thereunder, 17 CFR § 240.10b-5.

The fundamental purpose of the 1934 Act "was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." *Basic Inc. v. Levinson,* 485 U.S. 224, 234, 108 ***1079** S.Ct. 978, 985, 99 L.Ed.2d 194 (1988) (citations omitted). Consistent with this purpose, Section 10(b) states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange ... [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, entitled "Employment of manipulative and deceptive devices," states:

> It shall be unlawful for any person, directly or indirectly
>
> . . .
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

In action brought by the Commission pursuant to Section 10(b) and Rule 10b-5, the Commission must prove by a preponderance of the evidence all five of the following elements:

(1) The defendant, directly or indirectly, made an untrue statement of fact or (alternatively) omitted to state a material fact where he had a duty to speak; and

(2) The statement or omission was material; and

(3) The statement or omission was made "in connection with" the purchase or sale of a security; and

(4) The defendant made the statement or omission knowingly or recklessly; and

(5) The transaction involved interstate commerce, or the mails, or a national securities exchange.

Section 10(b); Rule 10b-5; *SEC v. First Jersey Sec., Inc.*, 890 F.Supp. 1185, 1209 (S.D.N.Y.1995) *SEC v. Hasho,* 784 F.Supp. 1059, 1106 (S.D.N.Y. 1992); *SEC v. Kluesner,* 834 F.2d 1438, 1439 (8th Cir. 1987).[3]

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[3] The court notes in passing that these elements are derived largely from subpart (b) of Rule 10b-5, which makes it unlawful "[t]o make any untrue statement of a material fact or to omit to state a material fact." etc.

[2] Drawing all reasonable inferences in favor of the Commission, the court finds that the factual allegations in the complaint support all five elements of a Section 10(b) claim. Therefore, the complaint states a claim upon which relief can be granted and survives Jakabowski's motion to dismiss.

1. UNTRUE STATEMENT OR OMISSION

The Commission must prove that Jakubowski directly or indirectly made an untrue statement of fact or (alternatively) omitted to state a fact where he had a duty to speak. The complaint establishes that Jakubowski made an untrue statement of fact with respect to the sale of stock by Cragin Corp.[4] ***1080** Jakubowski personally filled out a Stock Order

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Most cases concerning Rule 10b-5 focus on subpart (b) and largely ignore subpart (a), which makes it unlawful "[t]o employ any device, scheme, or artifice to defraud,' and subpart (c), which makes it unlawful to do anything that "would operate as a fraud or deceit upon any person." The briefs submitted in this case also focus on subpart (b) rather than subparts (a) and (c). Given the focus of the caselaw and the briefs, the court structures this Memorandum Opinion around the five elements listed above, derived largely from subpart (b). Notwithstanding the relatively vague language of subparts (a) and (c), the courts, the Commission, and private parties might look more closely at subparts (a) and (c) in future cases, especially those involving "novel" forms of fraud. *Cf. In re Towers Financial Corporation* Noteholders Litigation, 1995 WL 571888 at *15-16 (S.D.N.Y.1995) ("Plaintiffs must prove all the established elements of a Rule 10b-5 claim even when proceeding under Rule 10b-5(a) & (c).").

[4] The court focuses its analysis on Jakubowski's activities related to Cragin Bank's conversion from mutual to stock ownership. Because the court finds that the allegations in the complaint regarding these activities establish a violation of Section 10(b) and Rule 10b-5, it is unnecessary for the court to consider at this stage whether Jakubowski's other activities (related to Calumet Federal Savings and Loan, AmeriFed Financial Corporation, and Plains Spirit Financial Corporation) also constitute a

Form provided by Cragin Corp. On the form Jakubowski specifically indicated that the purchaser of 35,000 shares of Cragin stock was Diane Wrobel, a secretary at Jakubowski's law firm and an account holder at Cragin Bank. This was an untrue statement of fact because the purchaser was not the secretary; the purchaser was GCA or Hart, who was not an account holder at Cragin. After filling out the Stock Order Form, Jakubowski directed the secretary to sign it and then delivered the form to Cragin Corp.

[3] Jakubowski contends that the factual allegations in the complaint do not establish that he made an untrue statement of fact or omitted to state a fact within the meaning of Rule 10b-5. He offers several arguments in support of this contention, none of them persuasive.[5] First, Jakubowski argues

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violation of Rule 10(b). This approach is consistent with the parties' briefs and the complaint itself, which focus primarily on the Cragin Bank conversion. For the record, the court notes one potentially significant difference between the Cragin Bank conversion and the AmeriFed conversion: The complaint alleges that Jakubowski "borrowed money from Hart to purchase at least $48,000 of Conversion Stock in AmeriFed using an accountholders' Conversion Subscription Rights." (Amended Complaint ¶ 24.)

[5] Jakubowski argues--and the court agrees--that the complaint does not allege that he employed a "manipulative device" within the narrow meaning of Section 10(b). As the Supreme Court has explained,

"Manipulation" is "virtually a term of art when used in connection with securities markets.' The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity.

Santa Fe *Indus., Inc. v. Green,* 430 U.S. 462, 476, 97 S.Ct. 1292, 1302, 51 L.Ed.2d 480 (1977) (quoting *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 199, 96 S.Ct. 1375, 1383-84, 47 L.Ed.2d 668 (1976) (further cita-

that he is not liable because he "made no representations of fact to anyone, much less misrepresentations of fact." (Def.'s Mem. in Supp. at 21, 18.) As noted above, however, Jakubowski represented that the purchaser of the Cragin stock was a secretary at his firm, when in fact the purchaser was Hart or GCA.

[4] Second, Jakubowski argues that he is not liable because he personally "had no contact with the issuing thrifts." (Def.'s Mem. in Supp. at 18, 21, 27.) As noted above, however, Jakubowski not only filled out the form and directed the secretary to sign it; he also personally delivered the form to Cragin Corp. In this sense, Jakubowski clearly had contact with the issuing thrifts. Even if Jakubowski had not had direct contact with the issuing thrifts, his argument would fail because it rests on the mistaken theory that a party who has no contact with the "other side" cannot be liable for a violation of Section 10(b) and Rule 10b-5. This theory is inconsistent with the express language of Rule 10b-5, which imposes liability on any person who directly *or indirectly* makes any untrue statement of material fact. This theory is also inconsistent with *SEC v. Hoischuh,* 694 F.2d 130 (7th Cir.1982), which expressly rejects the theory that "actual or first-hand contact with offerees or buyers [is] a condition precedent to primary liability" for violations of Section 10(b). *Id.* at 142, *see also id.* at 140 (reaching same conclusion for violations of related securities laws).

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tions omitted)). The complaint does not appear to allege that Jakubowski engaged in any of these "manipulative devices." As set forth below, however, the complaint does allege that Jakubowski used a 'deceptive device ***1088**. or contrivance" under Section 10(b) and Rule lOb-5 in that he made a material misstatement in connection with the purchase or sale of a security.

Jakubowski's efforts to distinguish his case from *Holschuh* (Def.'s Mem. in Supp. at 22-24) are unpersuasive. Like Holschuh, Jakubowski "was a substantial and necessary participant" in the relevant transactions. *Holschuh,* 694 F.2d at 140. Jakubowski sought out the secretary, persuaded her to allow her conversion rights to be used, filled out the Stock Order Form, directed the secretary to sip it, and delivered the form to Cragin. Like Holschuh, Jakubowski was "responsible" for the relevant misstatement, and, conversely, the relevant misstatement was "traceable" to Jakubowski. *Id.* at 142.

***1081** [5] Third, Jakubowski argues that he is not liable because he did not sign the Stock Order Form. (Def.'s Mem. in Supp. at 21-22, 27.) According to the complaint, however, Jakubowski filled out the form, provided his own name and address in the address box, directed the secretary to sign the form, and delivered the form to Cragin. These actions clearly support a finding that Jakubowski made an untrue statement of fact under Rule 10b-5, which must be read "flexibly, not technically and restrictively. " *In re Leslie Fay Companies,* 871 F.Supp. 686, 696 (S.D.N.Y.1995) (quoting *Superintendent of Ins. v. Bankers Life and Casualty Co.,* 404 U.S. 6, 12, 92 S.Ct. 165, 168-69, 30 L.Ed.2d 128 (1971)). Jakubowski cites no authority for the proposition that Rule 10b-5 extends to the person who signs a document containing an untrue statement of material fact but not to the person who prepares the document, counsels another to sign the document, and delivers the document. The Seventh Circuit apparently reached the opposite conclusion when it noted that a defendant cannot escape liability for securities fraud "by participating in all except the final steps" of a transaction. *Holschuh,* 694 F.2d at 140.

[6] Fourth, Jakubowski argues that he is not liable because he owed "no duty of disclosure" to the issuing thrifts. (Def.'s Mem. in Supp. at 18, 21, 28.) Rule 10b-5 makes it unlawful for any person to make a misrepresentation of material fact or *alternatively* to make an omission of material fact where there is a duty to speak. Rule 10b-5; *SEC v. First Jersey Sec., Inc.*, 890 F.Supp. 1185, 1209 (S.D.N.Y.1995). The duty to speak arises only where the plaintiff alleges an omission of material fact, not where the plaintiff alleges an affirmative misstatement of material fact. *Id.; see Schatz v. Rosenberg*, 943 F.2d 485, 490 (4th Cir. 1991) (citing *Barker v. Henderson, Franklin, Stames & Holt*, 797 F.2d 490, 496 (7th Cir.1986) (noting that duty to speak required where claim alleges failure to speak, not where claim alleges affirmative misstatement), *cert. denied*, 503 U.S. 936, 112 S.Ct. 1475, 117 L.Ed.2d 619 (1992)). As explained above, the complaint alleges that Jakubowski made an affirmative misstatement of fact. This makes it unnecessary for the court to consider the alternative possibility that Jakubowski also made an omission of material fact where he had a duty to speak.[6] For present purposes, therefore, it is irrelevant whether Jakubowski had a duty to speak.

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[6] ***1088**. Were the court to consider this issue, the court would be inclined to agree with Jakubowski that he had no generalized preexisting duty to disclose information to Cragin Corp. However, by filling out and delivering the Stock Order form, Jakubowski arguably gave rise to a duty to disclose. As the Sixth Circuit recently explained,

A person undertaking to furnish information which is misleading because of a failure to disclose a material fact is a primary participant [in a violation of Section 10(b) and Rule 10b-5]. Conversely, a person who does not undertake to furnish any information, and who is not aware of what information has been furnished, is under no duty to disclose material information in his possession.

Fifth, Jakubowski argues that he is not liable because a professional is not responsible for the misrepresentations of another, even when he is aware of those misrepresentations. (Def.'s Mem. in Supp. at 25-28; Def.'s Reply at 6-7.) This argument is fundamentally flawed because this case involves a misrepresentation by Jakubowski, not a misrepresentation by "another.' In light of this fact, the cases cited by Jakubowski[7] are irrelevant because they do not involve professional persons who make affirmative misrepresentations. Rather, they involve professionals who fail to 'blow the whistle' on clients who make affirmative misrepresentations. *See Schatz,* 943 F.2d at 491 (noting difference between professionals who make "affirmative misrepresentations' and professionals who simply "fail to tattle on their client[s]").

***1082** [7] Sixth, Jakubowski argues that he is not liable because he was "little more than a finder,' citing *SEC v. Great American* Industries, Inc., 407 F.2d 453, 460-61 (2d Cir.1968), *cert. denied, 395* U.S. 920, 89 S.Ct. 1770, 23 L.Ed.2d 237 (1969). (Def.'s Mem. in Supp. at 22.) In *Great American,* Judge Friendly observed that imposing a duty to disclose on a finder in a real estate transaction "would require most careful consideration." *Great American,* 407 F.2d

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Molecular Technology Corp. v. Valentine, 925 F.2d 910, 917 (6th Cir.1991) (citing *SEC v. Washington County Util. Dist.,* 676 F.2d 218, 223 (6th Cir. 1982)); *see Schatz,* 943 F.2d at 491 (noting that attorneys may be liable for failure to disclose when they issue misleading legal opinions but not when they merely fail to "blow the whistle" on their clients).

[7] *Renovitch v. Kauftnan,* 905 F.2d 1040 (7th Cir. 1990); *Barker; Schatz; Abell v. Potomac Ins. Co.,* 858 F.2d 1104 (5th Cir.1988), *vacated on other grounds,* 492 U.S. 914, 109 S.Ct. 3236, 106 L.Ed.2d 584 (1988).

at 460-61. This observation has little relevance to the instant case. In the first place, Judge Friendly expressly declined to answer the question he raised. *See id.* at 461 (finding "no need" to address the question). In the second place, even if a finder in a real estate transaction had no duty to disclose, that would preclude liability for omissions of fact but not for affirmative misstatements of fact. In the third place, Jakubowski was not a finder in a real estate transaction. He clearly did more than "find" the secretary: He filled out the Stock Order Form (making an untrue statement of fact), directed the secretary to sign the form, and delivered the form to Cragin.

[8] Seventh, Jakubowski argues that he is not liable because he did not "control" the secretary who signed the form. (Def.'s Mem. in Supp. at 24-25.) This argument is both unpersuasive and irrelevant. The argument is unpersuasive because Jakubowski did in fact "control" the secretary to the extent necessary to make him responsible for her signature on the form. Jakubowski sought out the secretary, persuaded her to let her conversion rights be used, filled out the form, directed the secretary to sign the form, and delivered the form to Cragin. To the extent that the secretary's signature amounts to a misstatement of fact within the meaning of Rule 10b-5, Jakubowski was responsible for that misstatement. In this sense, the factual allegations in the complaint would allege that Jakubowski made an untrue statement of fact not only directly (when he filled out and delivered the form) but also indirectly (when he directed the secretary to sign it). In any event, the argument is irrelevant because Jakabowski himself made an untrue statement of fact when he filled out and delivered the Stock Order Form. Whether the secretary also made a misstatement when she signed the form

under the acknowledgment, and whether Jakubowski "controlled" her when she made the misstatement, is irrelevant.

Jakabowski cites *Barker* for the proposition that a professional cannot "control" a third party (Def.'s Mem. in Supp. at 24-25), but *Barker* has no direct bearing on this case. The short passage of *Barker* cited by Jakubowski, 797 F.2d at 494, does not address liability under Section 10(b) of the Securities Act of 1934. Instead, it addresses liability under Section 15 of the Securities Act of 1933, which specifically imposes liability on anyone who "controls any person liable under sections 11 or 12" of that act. *Id.* Neither Barker nor any other case cited by Jakubowski "imports" this specific analysis from Section 15 of the Securities Act of 1933 to Section 10(b) of the Securities Act of 1934. The subsequent passages of *Barker* that do address Section 10(b) merely hold that failure to blow the whistle does not create liability unless the defendant has a duty to blow the whistle. *See id.* at 495-96. As noted above, this holding is relevant to cases that allege omissions of material fact but not to cases that--like the case at bar--allege an affirmative misstatement of material fact.

II. MATERIALITY

[9] The Commission must prove that Jakubowski's misstatement was "material." It is well-established that "[a]n omission or misstatement is material if a substantial likelihood exists that a reasonable investor would find the omitted or misstated fact significant in deciding whether to buy or sell a security, and on what terms to buy or sell." *Branch-Hess Vending Services Employees' Pension Trust v. Guebert,*

751 F.Supp 1333, 1340 (C.D.111.1990) (citing *Basic Inc. v. Levinson,* 485 U.S. 224, 231, 108 S.Ct. 978, 983, 99 L.Ed.2d 194 (1988)). "Materiality has an element of causation built in, because a statement is material only if it so alters the 'total mix' of information available to the investor that it has the potential to affect the [investment] decision." *LHLC Corp. v. Cluett, Peabody & Co.,* 842 F.2d 928, 931 (7th Cir.) (citing *TSC Indus., Inc. v. Northway, Inc.,* *1083 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976)), *cert. denied,* 488 U.S. 926, 109 S.Ct. 311, 102 L.Ed.2d 329 (1988). The purpose of the materiality element is "to filter out essentially useless information that a reasonable investor would not consider significant, even as part of a larger 'mix' of factors to consider in making his investment decision." *Basic,* 485 U.S. at 234, 108 S.Ct. at 985 (citing *TSC,* 426 U.S. at 448-49, 96 S.Ct. at 2131-32).

[10] In this context the term "investment decision" necessarily encompasses decisions to sell as well as decisions to purchase securities. A narrower definition of "investment decision"--limited to the purchase of securities--might better comport with traditional notions of "investment." *Eg., Black's Law Dictionary* 741 (5th ed. 1979) (defining "investment" as "[a]n expenditure to acquire property or other assets in order to produce revenue'); *id.* at 518 (defining "expenditure" as "spending or payment of money"). However, such a narrow definition would contradict both the language of Section 10(b), which proscribes fraud "in the purchase *or sale* of any security" (emphasis added), and the underlying purpose of the section, which aimed to "cover frauds practiced on the seller as well as on the buyer," *Chemical Bank v. Arthur Andersen & Co.,* 726 F.2d 930, 941-42 (2d Cir.) (Friendly, J.), *cert. denied,* 469

U.S. 884, 105 S.Ct. 253, 83 L.Ed.2d 190 (1984). Such a narrow definition would also overturn numerous cases applying Section 10(b) to frauds on sellers. *E.g., Superintendent of Ins. v. Bankers Life and Casualty Co.,* 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed.2d 128 *(1971); Affiliated Ute Citizens of Utah v. United States,* 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972). Since the definition of "investment decision" includes the decision to sell, there can be no doubt that "[a] statement or an omission is material if it reasonably could have been expected to influence the decision to sell." *Nelson v. Serwold,* 576 F.2d 1332, 1335 (9th Cir.) (citing *Affiliated Ute Citizens,* 406 U.S. at 153, 92 S.Ct. at 1472), *cert. denied,* 439 U.S. 970, 99 S.Ct. 464, 58 L. Ed.2d 431 (1978).

[11] In this case, Jakubowski stated (falsely) on the Stock Order Form that the purchaser of the Cragin stock was the secretary (rather than Hart or GCA). This misstatement was material because it affected Cragin's investment decision. Specifically, it caused Cragin to sell 35,000 shares of stock to Hart or GCA rather than selling those shares to qualified holders of conversion rights. If Jakubowski had stated the truth on the Stock Order Form, then Cragin would not have sold the stocks to Hart or GCA because a regulation promulgated by the Office of Thrift Supervision ("OTS") prohibited the transfer of the secretary's conversion rights to Hart or GCA.

[12] Jakubowski argues that the OTS regulation did not actually prohibit his conduct.[8] OTS Regulation 12 CFR §

[8] Strangely, Jakubowski situates this argument at the end of his brief (Def.'s Mem. in Supp. at 28-30) rather than in his earlier discussion of materiality (Def.'s Mem. in Supp. at 19-21). For reasons set forth later

563b.3(i)(1), entitled "Prohibited transfers," states that "no person shall transfer, or enter into any agreement or understanding to transfer, the legal or beneficial ownership of conversion subscription rights, or the underlying securities to the account of another." Conceding that the regulation seems "broad in scope," Jakubowski nonetheless claims that "a review of the history and purpose behind this regulation reveals that it was never intended to prohibit simple depositors (and their sources of capital) from participating in the short-term price increase that typically follows thrift conversions." (Def's Mem. in Supp. at 29.) This argument has little merit. The history and purpose of the regulation cannot alter its plain meaning. *See, e.g., In re Sinclair,* 870 F.2d 1340, 1341 (7th Cir.1989) (holding that where legislative history contradicts words of statute, "the statute must prevail"). Given the plain meaning of the OTS regulation, the complaint clearly alleges that Jakubowski's conduct violated the regulation. It is fair to assume that if Cragin had been aware of the violation it would have refused to sell the stocks to Hart or GCA. Therefore, Jakubowski's ***1084** misrepresentation affected Cragin Corp.'s decision to sell Cragin stocks to CGA and Hart, making the misrepresentation 'material" for purposes of Rule l0b-5.

[13] Jakubowski argues that his statement on the Stock Order Form was not "material" because Cragin's decision to sell stocks to Hart and GCA was not an "investment decision.' (Def.'s Mem. in Supp. at 19-21.) Specifically, Jakubowski argues that his statement on the Stock Order Form had no effect on Cragin's decisions about whether to sell stock, how much stock to sell, and what price to charge

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in this Memorandum Opinion, however, the OTS regulation has little relevance to any aspect of this case other than materiality.

for the stock; Jakubowski's statement affected only the identity of the purchaser of 35,000 of those shares.

Whether a statement that affects only the identity of the purchaser of stock is "material" under Rule 10b-5 appears to be a question of first impression. The court concludes that such a statement is indeed material. In *Basic Inc. v. Levinson*, 485 U.S. 224, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988), the Supreme Court explained that the role of the materiality requirement is "to filter out essentially useless information that a reasonable investor would not consider significant, even as part of a larger 'mix' of factors to consider in making his investment decision." *Id.* at 234, 108 S.Ct. at 985. This leads the court to ask whether the identity of the buyer of Cragin stock was "essentially useless information that [Cragin Corp.] would not consider significant," or, conversely, whether it was useful information that Cragin would consider significant. The court finds that Cragin Corp. would consider the identity of the buyer 'significant" for at least two reasons. First, Cragin Corp. had an interest in abiding by OTS regulations and seeing to it that others abided by those regulations. Second, Cragin Corp. had in interest in ensuring that as many eligible accountholders as possible had the opportunity to purchase Cragin stocks. According to the Complaint,

> Cragin Stock was oversubscribed. by persons holding Conversion Subscription Rights. As a result, certain Cragin accountholders who attempted to exercise Conversion Subscription Rights were unable to purchase Cragin Stock at all or were only allowed to purchase a portion of what they had originally requested. GCA and Hart, however, were able to purchase the entire amount

> they requested at $10.00 per share. In addition, no Cragin Stock was made available to the general public in the initial offering and when it was subsequently available for public trading it opened at a price of $13.50 per share, substantially above the price paid by GCA and Hart.

(Complaint ¶ 17.) Because the Conversion Stock offerings were oversubscribed, the misstatement by Jakubowski and the subsequent purchase of Cragin Stock by Hart and GCA deprived eligible accountholders of the opportunity to buy $350,000 worth of Conversion Stock. The court finds that Cragin Corp. (like any reasonable savings association) would consider this harm to its accountholders "significant." That makes Jakubowski's misstatement "material."

In reaching the opposite conclusion, Jakubowski cites *LHLC Corp. v. Cluett, Peabody & Co.*, 842 F.2d 928, 931 (7th Cir.), *cert. denied*, 488 U.S. 926, 109 S.Ct. 311, 102 L.Ed.2d 329 (1988). In that case the buyer of department store company sued the seller and the seller's accounting firm, alleging that they overvalued the company's inventory. Although the seller valued the inventory before and on the closing date, the seller's accounting firm did not value the inventory until weeks after the closing date. *Id.* at 929-30. The Seventh Circuit held, per Judge Easterbrook, that the accounting firm's valuation was not "material" because it occurred after the closing date and therefore could not have affected the buyer's "investment decision." *Id.* at 931-32. In explaining this holding, Judge Easterbrook observed that:

> Materiality has an element of causation built in, because a statement is material only if it so alters the "total" mix

> of information available to the investor that it has the potential to affect the decision. But materiality usually refers to the importance of the information; a datum that would have only a small effect on the price is not material, while a datum with the potential for a larger effect is. The valuation of the inventory [in this case] would be ***1085** material in this usual sense, except for the fact that [the accounting firm] did not communicate with [the buyer] until after the closing. By then it was too late. The information, even if conventionally "material," did not affect the investment decision.

Id. at 931 (citation omitted).

The holding in LHLC in no way weakens the court's conclusion that Jakubowski's statement was "material." It is true that Jakubowski's misstatement occurred after Cragin Corp. decided to offer its accountholders a certain number of shares at a certain price. However, Jakubowski's misstatement occurred before Cragin Corp. decided to whom they would sell their stock, and Jakubowski's misstatement directly affected that decision.

[14] Jakubowski argues that his misstatement cannot be material because it did not affect the price of the stock sold by Cragin Corp. Jakubowski seizes on Judge Easterbrook's comment in *LHLC* (quoted above) that "materiality usually refers to the importance of the information; a datum that would have only a small effect on the price is not material, while a datum with the potential for a larger effect is." *Id.* Even if it were not dicta, this comment would not alter the result in the case at bar. Judge Easterbrook merely offered

price as a leading example of potentially material information. In the very next sentence, however, he indicated that price is not the only determinant of materiality: Timing can be important too. *See id.* Thus, far from suggesting that price is the only determinant of materiality, Judge Easterbrook's comment indicates that price is not the only determinant of materiality.

This result is hardly surprising. In cautioning courts against "confining materiality to a rigid formula," the Supreme Court stated that "[a]ny approach that designates a single fact or occurrence as always determinative of an inherently factspecific finding such as materiality, must necessarily be overinclusive or underinclusive." *Basic Inc. v. Levinson,* 485 U.S. 224, 236, 108 S.Ct. 978, 986, 99 L.Ed.2d 194 (1988). Rather than focus on a single factor such as price, the Supreme Court has advised "that materiality is something to be determined on the basis of the particular facts of each case." *Id.* at 238, 108 S.Ct. at 987 (citing *SEC v. Geon Indus., Inc.,* 531 F.2d 39, 47-48 (2d Cir. 1976) (Friendly, J.)). Based on the facts of this case, the court finds that Jakubowski's misstatement was material.

III. "IN CONNECTION WITH"

[15] Section 10(b) makes it unlawful to use a deceptive device "in connection with" the purchase or sale of a security, and Rule 10b-5 makes it unlawful to make a misstatement of material fact "in connection with" the purchase or sale of a security. *In Superintendent of Insurance v. Bankers Life and Casualty Co.,* 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971), a unanimous Supreme Court indicated that a de-

ception occurs "in connection with" the sale of a security when it "touches" the sale. *Id.* at 12-13, 92 S.Ct. at 168-69. Emphasizing that "Section 10(b) must be read flexibly, not technically and restrictively," *id.* at 12, 92 S.Ct. at 169, the court quoted with approval the case of *A.T. Brod & Co. v. Perlow,* 375 F.2d 393 (2nd Cir. 1967), in which the Second Circuit stated:

> We believe that [Section] 10(b) and Rule 10b-5 prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws.

Superintendent, 404 U.S. at 10-11 n. 7, 92 S.Ct. at 168 n. 7 (quoting *A.T. Brod,* 375 F.2d at 397) (emphasis in original). Drawing on the legislative history of Section 10(b), the Supreme Court continued: "Since practices 'constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad discretionary powers' in the regulatory agency 'have been found practically essential.'" *Superintendent,* 404 U.S. at 12, 92 S.Ct. at 169 (quoting legislative history). Thus, while the meaning of "in connection with" has varied somewhat in actions brought by private plaintiffs, the meaning of the phrase in actions brought by the Commission "remains as broad and flexible as is necessary to accomplish the statute's purpose of protecting investors." ***1086** *SEC v. Rana Research, Inc.,* 8 F.3d 1358, 1362 (9th Cir.1993). In actions brought by the Commission, "[f]raud touching the intrinsic value of securities *and the means of accomplishing the purchase of securities is*

sufficiently connected with securities transactions to bring the fraud within section 10(b)." *Id.* (citations omitted) (emphasis added).

[16] Jakubowski made a material misstatement "in connection with" the purchase or sale of a security when he falsely claimed that the purchaser of the Cragin stock was the secretary. His fraudulent claim not only "touched" the sale of securities, *Superintendent,* 404 U.S. at 12-13, 92 S.Ct. at 168-69; it was the very "means of accomplishing the purchase of securities," Rana, 8 F.3d at 1362. As such, Jakubowski's claim occurred "in connection with" the purchase or sale of a security and fell within the range of activities subject to enforcement actions by the Commission. *Id.* That Jakubowski's fraud was atypical "should not provide immunity from the securities laws." *Superintendent,* 404 U.S. at 10-11 n. 7, 92 S.Ct. at 168 n. 7 (quoting *A. T. Brod,* 375 F.2d at 397).

Jakubowski argues that his alleged statement did not occur 'in connection with" the purchase or sale of a security. In support of his argument he cites *Gurwara v. LyphoMed, Inc.,* 937 F.2d 380 (7th Cir. 1991), an action by a private plaintiff against his former employer. In that case the employer promised Gurwara dial a change from full-time employment to short-term disability status would not affect valuable stock option rights that Gurwara obtained previously. When Gurwara later sought to exercise his stock option rights, his employer refused to honor the promise, stating that Gurwara's change of status had terminated the rights. *Id.* at 381. Gurwara sued his former employer, asserting a federal claim under Section 10(b) and state claims for breach of contract and fraud.

The Seventh Circuit affirmed the dismissal of Gurwara's federal securities claim. Stressing that Gurwara's complaint "appear[ed] to state a good cause of action under state law," the court concluded that Gurwara failed to state a claim under Section 10(b) because the alleged misrepresentations "did not go to the value of the stock at issue or the value of the consideration in return for it." *Id.* at 383. Focusing on this language, Jakubowski argues that he made no statement "in connection with" the purchase or sale of a security because his statement did not concern the value of the Cragin stock or the value of the consideration that GCA and Hart paid for it. Although certain pronouncements in Gurwara lend superficial support to this argument, a careful analysis of the facts and controlling caselaw leads the court to a different conclusion.

In *Gurwara* the fraud did not "touch" the sale of a security because there was no sale of a security. Instead, there was a broken promise not to cancel an option to purchase securities.[9] After Gurwara's employer broke its promise and cancelled the option, the Seventh Circuit held that the appropriate remedy was a state action for breach of contract and common law fraud, not a federal action for securities fraud. In the case at bar, by contrast, there was a securities transaction and nothing but a securities transaction. Cragin Corp. sold $350,000 worth of Cragin stock to GCA and Hart, relying on Jakubowski's fraudulent claim that the purchaser of the stock was a qualified Cragin accountholder. Jakubow-

[9] The Seventh Circuit was careful to note that the parties in *Gurwara* treated the promised stock-not the stock option contract--as the relevant "security." The court expressly declined to address the question "[w]hether Gurwara might have sued successfully under section 10(b) for misrepresentations in connection with this *option contract*." *Id.* at 382 n. 2 (emphasis in original).

ski's fraudulent claim was the means of accomplishing an actual purchase of securities, bringing it the scope of an enforcement action brought by the Commission pursuant to Section 10(b).[10]

*1087 It is true, as Jakubowski points out, that the Seventh Circuit dismissed Gurwara's claim on the ground that his employer's misrepresentation "did not go to the value of the stock at issue or the value of the consideration in return for it." *Gurwara v. LyphoMed, Inc.*, 937 F.2d at 383. To the extent that this pronouncement states a rule of law, however, an analysis of other relevant cases suggests that such a rule must be limited to cases like *Gurwara*, where the misstatement at issue has little or no relationship to an actual securities transaction. In *Superintendent*, the Supreme Court specifically rejected the proposition that there can be no violation of Rule 10(b) where there is "no fraud is alleged as to the investment value of the securities.." 404 U.S. at 10-11 n. 7, 92 S.Ct. at 168 n. 7. (discussing *A. T. Brod*, 375 F. 2d at 396). In *Costello v. Oppenheimer & Co.*, 711 F.2d 1361 (7th

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[10] Like *Gurwara*, the other cases cited by Jakubowski are distinguishable from the case at bar. Three of the cases cited involved misrepresentations in non-securities transactions in which securities were incidentally involved. *See Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930 (2d Cir.), *cert. denied*, 469 U.S. 884, 105 S.Ct. 253, 83 L.Ed.2d 190 (1984) (corporation misstated its financial condition to secure bank loan; bank loan was secured in part by pledge of stock in corporation's subsidiary), *Hunt v. Robinson*, 852 F.2d 786 (4th Cir. 1988) (employer refused to honor earlier promise to tender securities to employee as part of employment contract), and *Citibank, N.A. v. K-H Corp.*, 745 F.Supp. 899 (S.D.N.Y.1990) (in commercial lending transaction, sole shareholder of corporation misrepresented ability to make cash equity contribution to corporation). In *In re Financial Corp. of Am. Shareholder Lit.*, 796 F.2d 1126 (9th Cir. 1986), the relationship between the misrepresentation and the securities was even more tangential. *See id.* at 1129 (likening case to *Palsgraf v. Long Island R.R.*, 248 N.Y. 339, 162 N.E. 99 (N.Y. 1928)).

Cir.1983), the Seventh Circuit held that the practice known as "churning"—"a course of excessive trading through which a broker advances his own interests (e.g., commissions based on volume) over those of his customer"--violates Section 10(b) and Rule 10b-5 as a matter of law. Yet "churning" involves neither the value of a security nor the value of the consideration given in return for a security. In *Marbury Management, Inc. v. Kohn,* 629 F.2d 705 (2d Cir.), *cert. denied,* 449 U.S. 1011, 101 S.Ct. 566, 66 L.Ed.2d 469 (1980), the Second Circuit held that a brokerage firm trainee who falsely represented that he was an experienced stockbroker violated Section 10(b) and Rule 10b-5, even though the trainee never misrepresented the value of a security. In reaching that conclusion, the Second Circuit expressly rejected a rule that would limit recovery under Section 10(b) to fraudulent misrepresentations about the value of a security because "[s]o concise a theory of liability for fraud would be too accommodative of many common types of fraud, *such as the misrepresentation of a collateral fact that induces a transaction. " Id.* at 710 n. 3 (emphasis added).[11]

In sum, the court finds that Jakubowski made a material misstatement "in connection with" the purchase or sale of a security because his misstatement "touched" an actual sale of securities in that it was the "means of accomplishing the purchase of securities."[12]

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[11] *See also Board of Trustees of Fire Fighters Pension Fund v. Poder,* 712 F.Supp 135 (N.D.Ill 1989) (unauthorized trading violates Rule 10b-5).

[12] In light of this finding, the court declines to consider the SEC's further argument that Jakubowski's misstatement related to the consideration for the conversion stock.

IV. SCIENTER AND JURISDICTIONAL MEANS

The Commission must prove that Jakubowski made the relevant statements knowingly or recklessly, and that jurisdictional means were used (e.g., interstate commerce, the mail, or a national securities exchange). The court finds--and Jakubowski does not appear to dispute--that the factual allegations in the complaint support both of these elements.

Because the factual allegations in the complaint support all of the elements of a Section 10(b) action brought by the Commission, the court concludes that the Commission has stated a claim upon which relief can be granted.

V. OTHER ISSUES

Jakubowski makes several arguments relating to the OTS regulation, but none of them justifies dismissal of the complaint against him. First, Jakubowski argues that he did not violate the OTS regulation. (Def.'s Mem. in Supp. at 28-29.) The court considered and rejected this argument above in connection with the "materiality" element.

*1088. Second, according to Jakubowski, the mere fact that Jakabowski may have violated the OTS regulation does not mean that he also violated Section 10(b). (Def.'s Mem. in Supp. at 11-13.) The court agrees. However, the allegations in the complaint show not only that Jakubowski violated the OTS regulation; they show that Jakubowski made a material misstatement in connection with the purchase or sale of a security, establishing every element of a Section 10(b) violation. As noted above, the only direct relevance of the OTS

regulation to the five elements of a Section 10(b) action brought by the Commission is that the OTS regulation made Jakubowski's misstatement material. Jakubowski cites *Santa Fe Industries, Inc. v. Green,* 430 U.S. 462, 97 S.Ct. 1292, 51 L.Ed.2d 480 (1977), which held that "a breach of fiduciary duty by majority stockholders, *without any deception, misrepresentation,* or nondisclosure" does not violate Section 10(b). *Id.* at 476, 97 S.Ct. at 1302 (emphasis added). But *Santa Fe* has no bearing on this case, because the allegations in the complaint demonstrate a material misrepresentation, not just a violation of the OTS regulation. Contrary to Jakubowski's claim, the complaint does not "bootstrap" a Section 10(b) violation onto an OTS violation.

Third, according to Jakubowski, the structure of the OTS regulations means that he did not violate Section 10(b). (Def.'s Mem. in Supp. at 14-16.) This argument, though highly creative, is wholly unpersuasive. The provision Jakubowski cites applies only to persons associated with savings associations; since Jakubowski was not associated with a savings association, the provision is irrelevant to this case. At an even more fundamental level, nothing in the OTS regulations can alter the meaning of Section 10(b) and Rule 10b-5.

Jakubowski also argues that he cannot be liable for a violation of Section 10(b) in light of the Supreme Court's recent decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,* 511 U.S. 164, 114 S.Ct. 1439, 128 L.Ed.2d 119 (1994). (Def.'s Mem. in Supp. at 30.) In that case the Supreme Court held that there is no liability for "aiding and abetting" under Section 10(b). As explained above, however, the allegations in the complaint show that

Jakubowski himself violated Section 10(b). The complaint does not and could not premise liability on a theory of "aiding and abetting."

Conclusion

For the reasons set forth above, the court denies Defendant Steven R. Jakubowski's motion to dismiss the complaint against him. The court instructs the parties to discuss settlement before the next court date.

APPENDIX B.

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS EASTERN DIVISION

SECURITIES AND EXCHANGE COMMISSION,	)	
Plaintiff,	)	
v.	)	Case No. 94 C 4539
STEVEN R. JAKUBOWSKI,	)	
Defendant.	)	

MEMORANDUM OPINION AND ORDER

Plaintiff Securities and Exchange Commission ("SEC") alleges that Defendant Steven R. Jakubowski ("Jakubowski") violated Section 10(b) of the Securities Exchange Act of 1934. The SEC and Jakubowski have filed cross motions for summary judgment under Rule 56 of the Federal Rules of Civil Procedure. For the reasons set forth below, the court grants the SEC's motion and denies Jakubowski's motion.

Background

At all times relevant to this case, Jakubowski practiced law in Illinois and worked at a law firm in Chicago, Illinois.

(Pl.'s 12(M) ¶ 2.)[1] In 1987, Jakubowski met Frank E. Hart ("Hart"), who managed a fund called Generation Capital Associates ("GCA"). Jakubowslci transacted business with Hart on two occasions in 1987 and 1988. (Pl.'s 12(M) ¶¶ 2, 3.)

During the years 1991 and 1992, a number of banks converted from mutual savings associations to capital stock associations. During such a conversion, a holding company would issue and sell conversion stock for the converting banks. The Office of Thrift Supervision ("OTS") issued rules to govern such conversions. The OTS required that each converting bank give its qualified account holders a nontransferable subscription right to purchase the new stock. The public could buy stocks of the converting banks only after all of the subscription rights were honored. In other words, qualified account holders had the right to buy these stocks before members of the general public. The OTS regulations prohibited a qualified account holder from transferring, or entering into an agreement to transfer, the ownership of these subscription rights or the securities themselves. (Pl.'s 12(M) ¶¶ 7, 8, 9.)

In late May of 1991, Hart contacted Jakubowski and told him that he wanted to find someone eligible to buy shares of the Cragin Federal Bank and Savings ("Cragin"), because this bank was converting from a mutual to a capital stock association. Hart informed Jakubowski that this stock, once issued to the public, would probably sell at about three dollars above the approximate subscription price of ten dollar

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[1] "Pl.'s 12(M)" refers to the SEC's statement of material facts submitted pursuant to Rule 12(M) of the Local Rules of this court.

per share. (Def.'s Cross 12(M) ¶¶ 8-10, 12.)[2] The two agreed that if Jakubowski found someone who had subscription rights (i.e., a qualified account holder in the bank), Hart would supply the money, sell the stocks, and give the account holder and Jakubowski a percentage of the profits. (Pl.'s 12(M) ¶ 14.)

Jakubowski sent a memorandum around his law firm in an effort to locate a qualified account holder of Cragin. He found a secretary in the firm who had an account at Cragin. After determining that this secretary did have subscription rights, Jakubowski filled out two stock order forms with the secretary's name and other information about the secretary.[3] One form requested 35,000 shares of Cragin stock, at approximately ten dollars a share (for which Hart would supply the money). The other form requested 1,000 shares of Cragin stock (for which a friend of Jakubowski, Thomas Hill ("Hill") would supply the money). The stock order form contained the following statement, above the signature line: "All rights exercised hereunder are not transferable and shares purchased upon exercise of such rights must be purchased for the account of the person exercising such rights."[4]

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[2] "Def.'s Cross 12(M)" refers to Jakubowski's statement of facts submitted in connection with his cross supplemental motion for summary judgment.

[3] This secretary asked a partner at the law firm whether he was familiar with this type of transaction. This partner had a brief conversation with Jakubowski, and Jakubowski assured the partner and the secretary that the secretary faced no financial risk from the transaction. (Def.'s Cross 12(M) ¶¶ 22, 22, 23.)

[4] A prospectus to the conversion further stated, under the heading, "Restrictions on Transfer of Subscription Rights and Shares":

However, Jakubowski had the stocks delivered to him, and he then forwarded the stocks to Hart and Hill. Jakubowski also had the secretary sign a stock power form giving Hart the power to trade these stocks. When the stocks were issued, Jakubowski forwarded them to Hart, who later sold them for a profit. At no time did Jakubowski or anyone else tell secretary she was receiving a loan, and no loan papers of any kind were involved in the transactions. Rather, Jakubowski or Hart received and controlled the stocks, Hart supplied the money, and Hart decided when to sell the stocks. Jakubowski was aware that the subscription form said an account holder cannot transfer the subscription rights involved. (Pl.'s 12(M) ¶ 20.)

After this initial transaction, Jakubowski learned that a number of other banks were converting from mutual to stock associations. Jakubowski informed Hart of these conversions, and Hart agreed to provide additional money. Jakubowski again sent a memorandum around his law firm[5] to find an account holder, this time in the Amerifed Corporation's ("Amerifed"), which was converting from a mutual savings association to a capital stock association. (Pl.'s

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> OTS conversion regulations prohibit any person with subscription rights . . . from transferring or entering into any agreement or understanding to transfer the legal or beneficial ownership of the subscription rights . . . or the shares of Common Stock to be issued upon their exercise.

(Pl.'s 12(M) ¶ 10.) The stock order form itself, however, did not contain this statement.

[5] Jakubowski states that this memorandum was approved by the firm's administrative manager.

12(M) ¶ 39, 47.) He did not locate anyone within his firm, but he did find three individuals outside the firm, William Wingate ("Wingate"), a house painter, Joseph Gebert ("Gebert"), a manager at a hardware store, and Douglas Racich ("Racich"), Jakubowski's dentist. (Pl.'s 12(M) ¶ 48.) Jakubowski told these individuals that an investor wanted to purchase Amerifed Stock through their accounts.

The Amerifed stock order form was a single page, which contained the following statement under the "Acknowledgment" heading:

> I understand that this stock order is for my account only and there is no agreement or understanding regarding the transfer of my subscription rights or any further sale or transfer of these shares. Subscription rights are non-transferable.

(Pl.'s 12(M) ¶¶ 62, 63.) Jakubowski had Wingate, Gebert and Racich sign stock order forms, and Jakubowski then filled in information on the forms to purchase shares of Amerifed stock: 23,900 shares through Wingate; 24,150 shares through Gebert; 48,000 shares through Racich. (Pl.'s 12(M) ¶ 64-68.) Hart wired the money to pay for these purchases. (Pl.'s 12(M) ¶ 71.)

For the Amerifed conversion, however, the offering of stock was oversubscribed, which required Amerifed to increase the amount of stock offered. Amerifed sent out a resolicitation form to determine if the account holders were still interested in purchasing the stocks, and offering them the option to reduce, increase or cancel their orders. The resolicitation form also contained an acknowledgment stating

that the stock order was for the account holder's account only, and that "there is no agreement or understanding regarding the transfer of my subscription rights or any further sale or transfer of these shares." (Pl.'s 12(M) ¶ 74.) During this re-solicitation, Jakubowski proposed to increase the amount of shares purchased thorough the subscription rights. Within the same period of time, Racich received a call from Amerifed questioning his transaction, and, as a result, Racich did not go through with the transaction. (Pl.'s 12(M) ¶ 84.) The funds that were returned from Amerifed for Racich's transaction were used to buy stocks through the accounts of Gebert, Wingate and Hill. (Pl.'s 12(M) ¶ 85.)

Jakubowski also attempted to find account holders in order to make similar transactions for the conversion of Calumet Bancorp ("Calumet"), Bell Federal Savings and Loan, Liberty Federal Savings and Loan, and Amity Federal Savings and Loan. (Pl.'s 12(M) ¶ 93.) After Jakubowski sent out an office memorandum, a secretary informed him that her father, Robert S. Lelo ("Lelo"), had an account at Calumet. Lelo signed a stock order form and a stock power form and gave them to Jakubowski, who filled out the forms to purchase 30,750 shares, once again with money from Hart. The form contained a similar statement that the subscription rights were not transferable, and that there was no agreement to transfer the shares of stock.[6] The offering of Calumet

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[6] A prospectus discussing the conversion also stated that "the OTS conversion regulations prohibit any person with subscription rights . . . from transferring or entering into any agreement or understanding to transfer . . . the subscription rights . . . or the shares of Common Stock to be issued upon their exercise. Such rights may be executed only by the person to whom they are granted and only for his account." The prospectus further stated: "[Calumet] and [Calumet Bancorp] will pursue any and all legal and equitable remethes in the event they become aware

stock was also oversubscribed, and certain qualified account holders were not able to purchase all the shares they requested.

The Calumet transaction differed from the others in that Jakubowski (at Hart's direction) prepared a memorandum stating that "these funds are being loaned to Robert S. Lelo for his purchase of 30,750 shares of Calumet." The memorandum did not state any interest rate or terms of repayment, however. (Pl.'s 12(M) ¶¶ 93, 95, 101, 105, 106.)

Jakubowski conducted another transaction for the conversion of First Federal, a bank run by Plains Spirit. In addition to the normal prohibitory language on the stock order form, the prospectus of the Plains Spirit conversion contained additional language discussing "Restrictions on Transferability."[7] Jakubowski located two individuals who were qualified account holders at First Federal, and filled out the forms to purchase 54,000 and 45,000 shares at a cost of $1,127,000 provided by Hart. (Pl.'s 12(M) ¶ 111, 112, 122, 124, 127.)

One of the account holders was a parent of Thomas Zack ("Zack"). (Zack was a friend of Jakubowski's friend, Hill.)

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of the transfer of subscription rights and will not honor orders known by them to involve the transfer of such rights." (Pl.'s 12(M) ¶ 90.)

[7] Under the heading "Regulatory Restrictions," the prospectus stated:

> A federal regulation prohibits any person prior to the completion of a conversion from transferring, or entering into any agreement or understanding to transfer, the legal or beneficial ownership of the subscription rights issued under a plan of conversion or the stock to be issued upon their exercise.

(Pl.'s 12(M) ¶ 112.)

Some problems occurred with the purchase through Zack's parent. During this transaction, an officer from First Federal went to Zack's father's home to inquire where he cot the money to pay for the stock. The bank officer also informed the man that he could not sell the subscription rights. Jakubowski informed Hart of what occurred, and Hart told Jakubowski that the purchase was legal since the money was only a loan to the account holder. However, Jakubowski later testified that there was no documentation that the two Plains Spirit transactions involved loans. (Pl.'s 12(M) ¶¶ 117, 130-133.)

Around the same time, another lawyer at Jakubowski's firm told Jakubowski that the language on the stock order form prevented transfer of the subscription rights, and prevented an agreement for transfer or sale of the stocks. Jakubowski stated that he knew that the subscription rights could not be transferred, but he did not know that an account holder could not enter into an agreement. (Pl.'s 12(M) ¶ 129.)

After speaking with this attorney about the legality of the deals, and after learning that the officer visited Zack's father's house informing him that the shares could not be transferred, Jakubowski did not correct or modify the stock order forms he submitted to purchase these stocks. (Pl.'s 12(M) ¶ 133.) For all of the transactions, Jakubowski received from Hart either a cash payment, or a portion of stock as payment. In total, Jakubowski filled out twelve stock order forms. All of the forms contained a statement or acknowledgment certifying that the account holder was purchasing the stock for his or her own account. Ten of the twelve forms (all except for the two Cragin forms) contained additional language preventing the transfer of subscription rights and the further sale or transfer of the shares. (Def.'s 12(M) ¶ 17.)

On October 12, 1994, the SEC brought this action against Jakubowski. In a Memorandum Opinion and Order dated January 2, 1996, this court denied a motion to dismiss filed by Jakubowski. SEC v. Jakubowski, 912 F. Supp. 1073 (N.D. 111. 1996). The SEC and Jakubowski have now filed cross motions for summary judgment. In his Response to the SEC's motion, Jakubowski also filed a "Cross Supplemental Motion for Summary Judgment."

Analysis

The court will render summary judgment only if the factual record shows "that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Bratton v. Roadway Package Sys., Inc., 77 F.3d 168, 173 (7th Cir. 1996) (quoting Fed. R. Civ. P. 56(c)). The court will not render summary judgment if "a reasonable jury could return a verdict for the nonmoving party. " Sullivan v. Cox, 78 F.3d 322, 325 (7th Cir. 1996) (citing Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986)). In ruling on a motion for summary judgment, the court views the facts in the light most favorable to the nonmoving party. Bratton, 77 F.3d at 171 (citation omitted); Sullivan, 78 F.3d at 325 (citation omitted).

On a motion for summary judgment, the moving party "bears the initial burden of showing that no genuine issue of material fact exists." Hudson Ins. Co. v. City of Chicago Heights, 48 F.3d 234, 237 (7th Cir. 1995) (citing Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986)). Then the burden shifts to the nonmoving party, which "must set forth specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e); accord, NLFC, Inc. v. Devcom Mid-America,

Inc., 45 F.3d 231, 234 (7th Cir. 1995) (citations omitted), cert. denied, 115 S. Ct. 2249 (1995).

These burdens are reflected in Rule 12 of the Local General Rules for the Northern District of Illinois. Waldridge v. American Hoechst Corp., 24 F.3d 918, 921-22 (7th Cir. 1994). Under Rule 12(M)(3), the moving party must submit a statement of material facts in the form of short numbered paragraphs supported by specific references to the factual record. Under Rule 12(N)(3), the nonmoving party must submit a response to each such paragraph, including (in the case of disagreement) specific references to the factual record.[8] If the nonmoving party fails to disagree with a fact in the moving party's 12(M) statement, the court will deem that fact admitted. See Local Rule 12(N)(3). Similarly, if the nonmoving party disagrees with a fact in the moving party's statement but fails to support its disagreement with a specific reference to the factual record, the court may deem that fact admitted as well. Fed. R. Civ. P. 56(e); Flaherty v. Gas Research Institute, 31 F.3d 451, 453 (7th Cir. 1994) (citations omitted). The Seventh Circuit Court of Appeals has "repeatedly upheld the strict enforcement of these rules." Waldridge, 24 F.3d at 922; e.g., Knoblauch v. DEF Express Corp., 86 F.3d 684, 690 (7th Cir. 1996).

Whether a disputed fact is material depends on the relevant substantive law. Anderson, 477 U.S. at 248; Sullivan, 78 F.3d at 325. The SEC alleges that Jakubowski violated

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[8] Rule 12(N)(3) further instructs the nonmoving party to submit a statement of any additional facts requiring denial of summary judgment, in the form of short numbered paragraphs supported by specific references to the factual record. In turn, Rule 12(M)(3) instructs the moving party to submit a concise reply to any such additional facts, including (in the case of disagreement) specific references to the factual record.

Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78j, as well as Rule 10b-5 promulgated thereunder, 17 CFR § 240. 10b-5. Jakubowski denies this. The fundamental purpose of the 1934 Act "was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry." Basic Inc. v. Levinson, 485 U.S. 224, 234 (1988) (citations omitted). Consistent with this purpose, Section 10(b) states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, entitled "Employment of manipulative and deceptive devices," states:

> It shall be unlawful for any person, directly or indirectly . . .
>
> (a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

In an action brought by the SEC pursuant to Section 10(b) and Rule 10b-5, the SEC must prove by a preponderance of the evidence all five of the following elements:

(1) The defendant, directly or indirectly, made an untrue statement of fact or (alternatively) omitted to state a material fact where he had a duty to speak; and

(2) The statement or omission was material; and

(3) The statement or omission was made "in connection with" the purchase or sale of a security; and

(4) The defendant made the statement or omission knowingly or recklessly; and

(5) The transaction involved interstate commerce, or the mails, or a national securities exchange.

Section 10(b); Rule 10b-5; SEC v. Hasho, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992); SEC v. Kluesner, 834 F.2d 1438, 1439 (8th Cir. 1987).

The court finds that no genuine issues of material fact exist on any of the five elements of the SEC's Section 10(b) claim. Therefore, the SEC's motion for summary judgment is granted and Jakubowski's motion for sununary judgment is denied.

I. UNTRUE STATEMENT OR OMISSION

The SEC must prove that Jakubowski directly or indirectly made an untrue statement of fact or (alternatively) omitted to state a fact where he had a duty to speak. The SEC presents a number of facts to show that Jakubowski made untrue statements on twelve different stock order forms. Specifically, Jakubowski filled out stock order forms with the names of the qualified account holders, when these account holders were not actually purchasing the stocks. The true purchaser was either Hart or GCA or (in a few transactions) Hill. The account holders never received control of the stocks, and they did not decide when to sell them. Jakubowski does not contest these facts, but rather argues in a number of different ways that his representations did not violate the OTS regulations, and therefore were not false.

First, Jakubowski looks to the regulatory history behind the OTS rules which prevent transfer of subscription rights. Based on this regulatory history, he argues that he has not

violated the OTS regulations. From this assumption, he then implies that since he has not violated the OTS regulations, his statements must not be false.[9]

The OTS language clearly states that "no person shall transfer, or enter into any agreement or understanding to transfer, the legal or beneficial ownership of conversion subscription rights, or the underlying securities to the account of another." As this court decided in its prior opinion denying Jakubowski's motion to dismiss, "the history and purpose of this regulation cannot alter its plain meaning." SEC v. Jakubowski, 912 F. Supp. 1073, 1083 (N.D. Ill. 1996) (citing In re Sinclair, 870 F.2d 1340, 1341 (7th Cir. 1989)). According to the clear language, Jakubowski did violate the OTS rule when he indicated that the subscription rights holder was the purchaser, when in fact the shares were purchased by GCA or Hart.

Even if his statements did not violate the OTS regulations, they still could be untrue under the 1934 Act. Jakubowski is not being sued for a violation of the OTS rules. "He is being sued for violation of Securities laws. Thus, what is relevant is whether his statements or omissions were untrue under Section 10(b) of the Securities Act. His statements can still be untrue under the Securities Act, even if the OTS regulations were not violated. See U.S. v. 105,800 Shares of Common Stock of FirstRock Bancorp, Inc., 830 F. Supp. 1101, 1127 (N.D. Ill. 1993) (finding that a false statement can violate a federal bank fraud statute even if it does not violate the OTS regulations.)

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[9] He makes these argument in his "Memorandum of Law in Support of Defendant's Cross Supplemental Motion for Summary Judgment and in Response to Plaintiff s Motion for Summary Judgment."

Second, Jakubowski relies on the deposition testimony of Philip Gerbick, the OTS regional deputy director. Jakubowski claims that Gerbick's testimony establishes that Jakubowski did not violate the OTS regulations. This court has already determined that whether the OTS regulations were violated is not the subject of this suit; and Jakubowski's argument is flawed in other respects as well. In the deposition, Gerbick was asked to determine if a number of hypothetical situations would violate the OTS regulations. Notably, Jakubowski mentions a scenario where a bank president lends money to a bank janitor so that the janitor and his wife could buy the maximum allotment of conversion shares. The janitor would later sell the shares, and the janitor and the president would split the proceeds. Gerbick responded to this hypothetical, "I imagine there's a way to structure it where it's legal, yes." (Pl.'s Reply Supp. Mot. Summ. J. Ex., BB, p. 43.)

The facts of this hypothetical, and of the other hypothetical situations presented to Gerbick, are significantly different than the facts of Jakubowski's transactions. With one possible exception, Jakubowski did not lend money to the account holders. The account holders never possessed the stocks or had any control over when the stocks were sold, and the account holders bore no financial risk from the transactions. In the hypothetical situations, however, these facts were present, significantly changing the outcome. Furthermore, whether or not there is a way to legally structure this type of transaction (through loans to account holders, for instance) is not relevant, because Jakubowski did not structure the deals that way.

Neither Jakubowski's regulatory history argument, nor the

statements of Gerbick, raise a genuine issue of material fact. Jakubowski's actions clearly support a finding that he made an untrue statement of fact under Rule 10b-5.

II. MATERIALITY

The SEC must also prove that Jakubowski's misstatements were material. "In his motion for summary judgment, Jakubowski argues that the statements he made on the subscription forms were not material because the identity of the purchaser would not affect an investment decision.

Jakubowski relies on a narrow reading of the term investment decision. He essentially argues that an investment decision is only material if it relates to economic factors alone.

This court analyzed the existing law on materiality in its earlier decision denying Jakubowski's motion to dismiss. See Jakubowski, 912 F. Supp. at 1082-85. In his current motion for summary judgment, Jakubowski argues that this court misconstrued the law on this issue. In his cross supplemental motion for summary judgment, Jakubowski also advances new arguments why his statements were not material. After carefully reviewing the existing case law, and Jakubowski's new arguments, this court finds that there is no genuine issue of material fact on the issue of materiality: his statements were material.

As stated in this court's earlier opinion, "whether a statement that affects only the identity of the purchaser of stock is 'material' under Rule 12b-5 appears to be a question of first impression." Jakubowski, 912 F. Supp. at 1084. It is well-established that "[a]n omission or misstatement is material if a substantial likelihood exists that a reasonable investor

would find the omitted or misstated fact significant in deciding whether to buy or sell a security, and on what terms to buy or sell." Branch-Hess Vending Services Employees' Pension Trust v. Guebert, 751 F. Supp 1333, 1340 (C.D. Ill. 1990) (citing Basic Inc. v. Levinson, 485 U.S. 224, 231 (1988)). "Materiality has an element of causation built in, because a statement is material only if it so alters the 'total mix' of information available to the investor that it has the potential to affect the [investment] decision. " LHLC Corp. v. Cluett, Peabody & Co., 842 F.2d 928, 931 (7th Cir.) (citing TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)), cert. denied, 488 U.S. 926 (1988). The purpose of the materiality element is "to filter out essentially useless information that a reasonable investor would not consider significant, even as part of a larger 'mix' of factors to consider in making his investment decision." Basic, 485 U.S. at 234 (citing TSC, 426 U.S. at 448-49). In this context the term "investment decision" necessarily encompasses decisions to sell as well as decisions to purchase securities. See Jakubowski, 912 F. Supp. at 1083.

According to Jakubowski, does not support the proposition that non-economic determinants such as the identity of the purchaser can be material. But nowhere does the Basic opinion state that non-economic factors cannot be material. Rather, supports a "fact-specific inquiry," 485 U.S. at 240, focussed on what the reasonable investor would find significant, id. at 231-32. Arguing that the identity of a stock purchaser is immaterial, Jakubowski cites to a dissenting portion of Justice White's opinion in Basic:

> [A] plaintiff who decides, months in advance of an alleged misrepresentation, to purchase a stock; one who buys or sells a stock for rea-

> sons unrelated to its price; one who actually sells a stock "short" days before the misrepresentation--surely none of these people can state a valid claim under Rule 10b-5 . . . .

However, Justice White in fact concurs with the majority's holding on materiality. The example offered by Justice White in his dissent relates to the "fraud on the market" theory, a separate issue involving private claims brought under 10b-5. It is not relevant to this action brought by the SEC.

Jakubowski relies on other cases to argue that the identity of the purchaser of conversion stocks is not relevant to the reasonable investor (i.e., the banks) because it does not 'affect the value' of the stocks. While many of the cases that Jakubowski relies on do discuss issues regarding the value of stocks, nothing in these cases suggests that only statements that affect the value of stocks are important. After reviewing the cases cited by Jakubowski and the SEC, this court relies on its analysis on the issue of materiality set forth in its opinion denying Jakubowski's motion to dismiss. See Jakubowski, 912 F. Supp. at 1082-85.

The identity of the purchaser can be material if a reasonable investor would find it significant. In this case, the true purchaser of the stocks certainly was a significant fact because that fact alone determined whether the banks would sell the stocks. The identity of the person determined the legality of the transaction. The banks not only had an interest in abiding by OTS regulations and seeing to it that others abided by those regulations, the banks also had an interest in ensuring that as many eligible account holders as possible had the opportunity to purchase the stocks. Jakubowski's misstatements caused the banks to sell stocks to unqualified

individuals, and in some cases the sale prevented qualified account holders from buying the shares that they requested. The result the court reaches is fully consistent with the Supreme Court's "fact-specific" approach in Basic Rather than focus on a single factor such as price, the Supreme Court has advised "that materiality is something to be determined on the basis of the particular facts of each case." 485 U.S. at 238 (citing SEC v. Geon Indus., Inc., 531 F.2d 39, 47-48 (2d Cir. 1976) (Friendly, J.)).

In his Cross Supplemental Motion, Jakubowski raises additional arguments as to why his activities were not material, based on the testimony of Philip Gerbick. Gerbick states that the OTS did not have any type of "interpretive guidelines" or "manuals" to limit the participation of "outside speculators (like Hart or GCA) in the conversion process." Jakubowski also states that "nothing in the record . . . indicates that the, Converting Thrifts established regular business procedures for screening applications" to discover if non-qualifying individuals were trying to purchase conversion stock. (Def.'s Mem. Supp. Cross Supplemental Mot. Summ. J. at 13.) Jakubowski argues that the absence of these rules or procedures means that the OTS or the banks did not care if outsiders obtained conversion stock. In other words, since the banks did not have any manuals on the subject, the issue was material to them.

This argument fails for a number of reasons. First of all, the banks did want to prevent non-qualified individuals from maintaining control of the stocks, as the law required. They clearly placed a certification on the subscription forms to prevent this. Furthermore, the evidence shows that some of the banks did look into the subscription agreements to see if they were legitimate. Specifically, Racich was contacted in the Amerifed conversion, and an First Federal officer visited

Zack's father regarding the Plains Spirit/First Federal conversion. A prospectus discussing the Calumet conversion stated that "[Calumet] and [Calumet Bancorp] will pursue any and all legal and equitable remethes in the event they become aware of the transfer of subscription rights and will not honor orders known by them to involve the transfer of such rights.' (Pl.'s 12(M) ¶ 90.) Thus, the fact that an account holder (rather than an outsider) was actually purchasing the shares was clearly material to the banks.

III. "IN CONNECTION WITH"

Jakubowski claims that the misstatements were not made "in connection with" the purchase or sale of a security. In the current cross-motions for summary judgment, no genuine issues of material fact are offered to defeat a legal judgment on this issue. In order to support his motion for summary judgment, Jakubowski rehashes issues fully considered by this court in its Memorandum Opinion and Order on Jakubowski's motion to dismiss. See Jakubowski, 912 F. Supp. at 1085-87. After reviewing the case law, and the legal arguments made by Jakubowski, the court finds that its original interpretation of the law on this issue is correct. See Jakubowski, 912 F. Supp. at 1085-87. Because no genuine issues of material fact exist on this issue, and the court finds that Jakubowski's misstatements were made in connection with the purchase of a security, the court declines to grant Jakubowski's motion for summary judgment on this issue.

IV. SCIENTER

The SEC must also prove that Jakubowski knowingly or recklessly made the misstatements. Jakubowski must have either "acted with the 'intent to deceive, manipulate or defraud," Ambrosino v. Rodman & Renshaw, Inc., 972 F.2d 776, 788 (7th Cir. 1991) (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976)), or "acted with 'reckless disregard for the truth of the material asserted,' whether by commission or omission," Ambrosino, 972 F.2d at 788 (citing Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1044 (7th Cir. 1977)). Sundstrand adopted a definition of recklessness as highly unreasonable conduct "involving not merely simple, or even inexcusable negligence, but an extreme departure from standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." Sundstrand, 553 F.2d at 1045.

After reviewing the facts, this court concludes that no genuine issue of material fact exists on Jakubowski's intentional or reckless conduct. Even construing the facts in a light most favorable to Jakubowski, any reasonable jury would conclude that Jakubowski's actions were intentional, or at least reckless.

Jakubowski personally filled out twelve order forms with the information of the qualified account holder, when the account holder was not the purchaser of the stocks. Rather, another individual was purchasing the stocks, either GCA or Hart (or in a few instances, Hill). All of the stock order forms contained language clearly stating that the rights to purchase the stocks were not transferable, and that the shares must be purchased for the account holder. Except for the two Cragin forms, all of the forms contained additional lan-

guage stating that there must be no agreement transferring subscription rights, nor any further sale or transfer of the shares. This language was also stated on the prospectuses for the bank conversions, and -- in the cases where stock orders were oversubscribed -- on additional materials sent by the bank.

Jakubowski states that he knew that the shares must be purchased for the account holder, but he did not think what he was violating this command. He further argues that, after the Cragin transaction, he did not read the language on any of the other stock order forms, essentially because he was 'burdened by the heavy responsibilities" at work. Instead, Jakubowski simply "mechanically" filled in the forms, not noticing the different language, and treating the forms "much like a red-lined document and only looking for obvious changes' between the forms and the Cragin form. (Def.'s Mem. Supp. Cross Supplemental Mot. Summ. J. at 4.)

This argument is wholly unpersuasive. At the very least, Jakubowski acted recklessly by failing to read the forms and failing to investigate the legality of the transactions. All he had to do in this case was read the language on the stock order forms to realize that the transactions were clearly prohibited. In most cases, these forms were only one page in length; reading the forms certainly would not be burdensome or difficult for an attorney at a major law firm. Furthermore, Jakubowski's treatment of the forms as a "red-line document' was at least reckless. He could not simply assume that the ten stock order forms he filled out were the same as the Cragin forms, especially since many of the forms looked different than the Cragin form.

Problems also developed in some of the transactions that Jakubowski conducted. Some time before the Plain Spirit conversion, an attorney at Jakubowski's firm questioned how

the deal could be legal. Jakubowski, however, did not contact Plains Spirit to ask about the legality of the purchase. In addition, Jakubowski learned that an officer from First Federal (part of the Plains Spirit conversion) went to the Zack's house and informed the account holder that the subscription rights were not transferable. Although Jakubowski testified that he "thought there was a problem," he did not correct the stock order form he submitted to Plains Spirit. Despite the problems that Jakubowski ran into, he did not investigate to determine the legality of his transactions. Jakubowski advances a great number of inventive but unpersuasive arguments as to why he did not possess the requisite intent -- attempting to show the steps he took, and the people he relied upon, to make him believe the transactions were legal. First, he argues that the memorandum he circulated around his law firm to find qualified account holders of the various converting banks was "approved by the firm's office manager." (Def.'s Mem. Supp. Cross Supplemental Mot. Summ. J. at 17.) Second, he states that discussing the Cragin transaction with a partner in the firm reassured Jakubowski that the transaction was proper. Third, he conducted a "broad LEXIS/NEXIS search to confirm the legality of the transactions." However, these facts do not support his claim of a lack of scienter. The approval of the office memorandum had nothing to do with the transaction itself, and was nothing more than a routine permission to circulate a memo around the office. Similarly, Jakubowski's conversation with the partner did not involve the details of the Cragin transaction. The partner stated that he and Jakubowski never discussed the legality of the transaction, and that he never even read the subscription form. (Pl.'s Cross 12(n) Ex. GG, p. 298-99.) Finally, Jakubowski did not need to conduct LEXIS/NEXIS search; all he needed to do was read the restrictions in the

prospectus, or read the clear language on ten of the twelve forms.

While defendant states that his failure to read the prospectus of the Cragin conversion, or to research the law, demonstrates his "immaturity of judgment in addressing complex banking and securities laws, " Jakubowski did not have to do complex research--he could have simply telephoned the bank. In later transactions, all he had to do was read the clear language on the stock order forms.

Because of the clear restrictions written directly on the subscription forms, combined with the indications Jakubowski encountered suggesting the transactions were improper, this court finds that Jakubowski acted at least recklessly, and at times intentionally. Therefore, this court denies Jakubowski's motion for summary judgment on the issue of scienter.

V. JURISDICTIONAL MEANS

The SEC must also prove that the necessary jurisdictional means were used (e.g., interstate commerce, the mail, or a national securities exchange). No genuine issue of material fact exists as to this issue, and Jakubowski does not dispute that the mail and overnight delivery services were used in connection with the transactions.

Conclusion

For the reasons stated above, the court grants the SEC's motion for summary judgment and denies Jakubowski's motion for summary judgment.

ENTER:

/s/_____
Ann Claire Williams, Judge
United States District Court

Dated: MAR 31 1997

APPENDIX C.

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS EASTERN DIVISION

SECURITIES AND EXCHANGE COMMISSION,	)	
Plaintiff,	)	
V.	)	Case No. 94 C 4539
STEVEN R. JAKUBOWSKI,	)	
Defendant.	)	

MEMORANDUM OPINION AND ORDER

In a Memorandum Opinion and Order dated March 31, 1997, the court granted the motion for summary judgment filed by Plaintiff Securities and Exchange Commission ("SEC") and denied the motion for summary judgment filed by Defendant Steven R. Jakubowski ("Jakubowski"). The SEC now moves the court to enter final judgment in the form of (1) a permanent injunction, (2) disgorgement and pre-judgment interest, and (3) a civil penalty. Jakubowski opposes this motion, arguing that these measures are unnecessary and inappropriate. For reasons explained below, the SEC's motion is granted in part and denied in part.

I. PERMANENT INJUNCTION

The SEC asks the court to enter a permanent injunction that in effect restrains Jakubowski from ever again violating Rule 10b-5 (17 C.F.R. § 240.10b-5), promulgated under Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j).

> In an action for a statutory injunction, once a violation has been demonstrated, the moving party need only show that there is a reasonable likelihood of future violations in order to obtain [injunctive] relief. In predicting the likelihood of future violations, a court must assess the totality of the circumstances surrounding the defendant and his violation, including such factors as the gravity of harm caused by the offense; the extent of the defendant's participation and his degree of scienter; the isolated or recurrent nature of the infraction and the likelihood that the defendant's customary business activities might again involve him in such transactions; the defendant's recognition of his own culpability; and the sincerity of his assurances against future violations.

SEC v. Holschuh, 694 F.2d 130, 144 (7th Cir. 1982) (citations and footnote omitted); see also SEC v. Fehn, 97 F.3d 1276, 1295-96 (9th Cir. 1996) (employing similar standard); SEC v. Moran, 944 F. Supp. 286, 294 (S.D.N.Y. 1996) (same); SEC v. Kimmes, 799 F. Supp. 852, 860 (N.D.

Ill. 1992) (same, citing Holschuh), affd, 997 F.2d 287 (7th Cir. 1993). In weighing these factors, "the court may properly view a culpable defendant's continued protestations of innocence as an indication that injunctive relief is advisable." SEC v. Lorin, 76 F.3d 458, 461 (2nd Cir. 1996) (citation omitted). Moreover, "[t]he existence of past violations may give rise to an inference that there will be future violations; and the fact that the defendant is currently complying with the securities laws does not preclude an injunction." Fehn, 97 F. 3d at 1295 (citation omitted).

In this case, the court has already found that Jakubowski committed securities fraud on multiple occasions, despite unmistakable warning signs that his actions were improper. Yet in motions and supporting briefs filed in this court, Jakubowski has repeatedly denied that he ever violated any securities laws. As a relatively young attorney, Jakubowski will have many opportunities to violate securities laws in the future. Considering the totality of the circumstances in this case, the court finds a reasonable likelihood that Jakubowski will violate the securities laws in the future. Therefore, the court will permanently enjoin Jakubowski from violating securities laws and rules in the future, using the language recommended by the government. See Fehn, 97 F.3d 1276 (upholding permanent injunction against attorney who prepared three fraudulent reports more than five years before trial).

II. DISGORGEMENT AND PREJUDGMENT INTEREST

The SEC wants Jakubowski to disgorge his illegally-obtained profits and prejudgment interest on those profits.

This type of disgorgement prevents unjust enrichment. SEC v. Cross Financial Services, Inc., 908 F. Supp 718, 734 (C. D. Cal. 1995).

> Once the district court has found federal securities law violations, it has broad equitable power to fashion appropriate remethes, including ordering that culpable defendants disgorge their profits. The primary purpose of disgorgement as a remedy for violation of the securities laws is to deprive violators of their ill-gotten gains, thereby effectuating the deterrence objectives of those laws. "The effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable. The deterrent effect of an SEC enforcement action would be greatly undermined if securities law violators were not required to disgorge illicit profits."

SEC v. First Jersey Securities, Inc., 101 F.3d 1450, 1474 (2nd Cir. 1996) (citations omitted); accord, Moran, 944 F. Supp. at 295.

As part of the disgorgement order it seeks, the SEC wants Jakubowski to pay prejudgment interest on his illegally-obtained profits.

> In deciding whether an award of prejudgment interest is warranted, a court should consider "(i) the need to fully compensate the wronged party for actual damages suffered, (ii) considerations of fairness and the relative equities of

> the award, (iii) the remedial purpose of the statute involved, and/or (iv) such other general principles as are deemed relevant by the court." In an enforcement action brought by a regulatory agency, the remedial purpose of the statute takes on special importance.

First Jersey Securities, 101 F.3d at 1476 (citations omitted). In an enforcement action brought by the SEC, any disgorgement order "should include all gains flowing from the illegal activities. . . . [including] prejudgment interest[,] to ensure that the wrongdoer does not profit from the illegal activit[ies]." Cross Financial Services, 908 F. Supp at 734. This "prevents a defendant from obtaining the benefit of what amounts to an interest free loan procured as a result of illegal activity."

Moran, 944 F. Supp. at 295. When the SEC orders disgorgement of illegally obtained profits, it generally calculates prejudgment interest according to the underpayment rate published by the Internal Revenue Service. First Jersey Securities, 101 F.3d at 1476.

> That rate reflects what it would have cost to borrow the money from the government and therefore reasonably approximates one of the benefits the defendant derived from its fraud. Accordingly, courts have approved the use of the IRS underpayment rate in connection with disgorgement.

Id.

In this case, the court does not hesitate to order Jakubowski to disgorge his illegally-obtained profits. Having found that Jakubowski violated the securities laws, the court will not let Jakubowski retain his ill-gotten gains. To do so would unjustly enrich Jakubowski and undermine the deterrent effect of the securities laws. In addition, the court does not hesitate to order Jakubowski to pay prejudgment interest on his illegally-obtained profits. Since Jakubowski was never entitled to his illegally-obtained profits, he is also not entitled to the interest he has earned (or could have earned) from these profits. In light of the overall purpose of the securities laws, as well as considerations of fairness and equity in this case, the court orders Jakubowski to disgorge the $51,500.74 that he illegally obtained and to pay prejudgment interest in the amount of $26,922.49 (based on the underpayment rate published by the Internal Revenue Service).

III. CIVIL PENALTY

The SEC asks the court to impose a civil penalty on Jakubowski under the Securities Enforcement Remethes and Penny Stock Reform Act of 1990, 15 U.S.C. § 78u(d)(3)(A) ("Securities Enforcement Act" or "Act"). The Securities Enforcement Act provides that the amount of any such penalty "shall be determined by the court in light of the facts and circumstances" of the case. 15 U.S.C. § 78u(d)(3)(B). However, the Act sets upper limits on the penalty the court may impose. In cases involving "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement" but not involving substantial losses or the risk of substantial losses to others, "the amount of penalty for each such violation shall not exceed the greater of (1) $50,000 for a natural

person or $250,000 for any other person, or (11) the gross amount of pecuniary gain to [the] defendant as a result of the violation." 15 U.S.C. § 78u(d)(3)(B); see also 15 U.S.C. § 78u(d)(3)(C) (allowing steeper penalties in cases involving substantial losses or the risk of substantial losses to others).

The legislative history of the Securities Enforcement Act indicates that "Congress sought to achieve the dual goals of punishment of the individual violator and deterrence of future violations." Moran, 944 F. Supp. at 296. In passing the Act, Congress recognized that one common remedy, disgorgement,

> merely requires the return of wrongfully obtained profits; it does not result in any actual economic penalty or act as a financial disincentive to engage in securities fraud. A violator who avoids detection is able to keep the profits resulting from illicit activities. Currently [prior to the Act], even a violator who is caught is required merely to give back his gains with interest, leaving him no worse off financially than if he had not violated the law. The [House] Committee therefore concluded that authority to seek or impose substantial money penalties, in addition to the disgorgement of profits, is necessary for the deterrence of securities law violations that otherwise may provide great financial returns to the violator.

Id. (quoting legislative history of Act).[1]

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[1] Incidentally, the above-quoted statement of the House Committee that "a violator who is caught is required merely to give back his gains

In this case, the court could impose on Jakubowski a total penalty of several hundred thousand dollars, or $50,000 for each of Jakubowski's illegal actions. The SEC has asked the court to impose a penalty of $51,500.74, equal to the amount of Jakubowski's pecuniary gain, excluding interest. Although a larger penalty could be justified in this case, the court finds that a penalty of $51,500.74 appropriately reflects the general need to deter violations of the securities laws and the particular facts of this case. In assessing this penalty, the court recognizes that Jakubowski's violations of the securities laws -- and their aftermath -- have already affected both his career and his pocketbook. However, the court emphasizes that Jakubowski committed securities fraud not on one occasion but on multiple occasions. Although Jakubowski repeatedly complains that his actions were not illegal and that (at a minimum) he did not know his actions were illegal, the court finds these complaints unpersuasive. If Jakubowski really cared whether his actions were legal, he could have picked up his telephone, called one of the banks, and asked them for an opinion. He never did so. Despite the plain language of the stock order forms, despite numerous warning signs suggesting that his actions were illegal, despite years of higher education, and despite his position as a lawyer at an elite law firm, Jakubowski not only continued to engage in unlawful activities but in effect recruited and encouraged others less sophisticated than himself to do the same.

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with interest" supports the court's decision in this case to order Jakubowski to pay prejudgment interest on his ill-gotten gains.

Conclusion

The court grants the motion of Plaintiff Securities and Exchange Commission to enter final judgment against Defendant Steven R. Jakubowski in the form of (1) a permanent injunction, (2) disgorgement and prejudgment interest, and (3) a civil penalty. The court instructs the SEC to submit a clean copy of its proposed order for the court to sign.

ENTER:

/s/
Ann Claire Williams,
Judge

Dated: SEP 12 1997

APPENDIX D.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

SECURITIES AND EXCHANGE COMMISSION,	) CIVIL ACTION) FILE NO. 94 C 4539
Plaintiff,	)
v.	) JUDGE ANN C.) WILLIAMS
STEVEN R. JAKUBOWSKI,	)
Defendant.	)

FINAL JUDGMENT OF PERMANENT INJUNCTION AND OTHER RELIEF AGAINST STEVEN R. JAKUBOWSKI

This action came to be heard before the Court, the Honorable Ann C. Williams, District Judge, presiding, pursuant to Rule 56 of the Federal Rules of Civil Procedure, on the motion of the securities and Exchange Commission ("SEC") for Summary Judgment. On the entire record of the case, including SEC's Motion for Summary Judgment, its Statement of Undisputed Facts and Exhibits thereto, its Memorandum of Law in Support of Motion for Summary Judgment, and

Reply Memorandum in Support of its Motion for Summary Judgment and in Opposition to Defendant's Cross Supplemental Motion for Summary Judgment, and Exhibits thereto, the Court is fully advised in the premises. **THEREFORE:**

I.

IT IS HEREBY ORDERED THAT, for the reasons set forth in the Court's opinion dated March 31, 1997, SEC's Motion for Summary Judgment against Defendant Steven R. Jakubowski is GRANTED.

II.

IT IS FURTHER ORDERED, ADTUDGED AND DECREED that Defendant Steven R. Jakubowski, his agents, servants, employees, attorneys, and those persons in active concert or participation with him who receive actual notice of this Final Judgment of Permanent Injunction by personal service or otherwise, and each of them, be, and hereby are, permanently restrained and enjoined from, directly or indirectly, in connection with the purchase or sale of any security, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange:

(1) employing any device, scheme or artifice to defraud;
(2) making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the state-

ments made, in the light of the circumstances under which they were made, not misleading; or

(3) engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

III.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that Defendant Jakubowski shall disgorge the sum of $51,500.74, plus $26,922.49 in prejudgment interest, by depositing this amount into the registry of the Court within thirty (30) days of the entry of this Final Judgment of Permanent injunction.

IV.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that Defendant Jakubowski shall pay, pursuant to Section 21(d)(3) of the Securities Exchange Act of 1934 [15 U.S.C. 5 78u(d)(3)], a civil penalty of $51,500.74 within thirty (30) days of the entry of this Final Judgment of Permanent Injunction. Payment of the civil penalty shall be: (1) made by cashier's check, certified check, or United States postal money order; (2) made payable to the Securities and Exchange Commission; and (3) mailed to the Comptroller of the SEC at the SEC's office, 450 5th Street, N.W., Mail Stop 0-3, Washington, D.C. 20549, with a cover letter identifying the name and case number of this litigation, the name of the court, and the SEC's case number, C-2690.

V.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that this Court shall retain jurisdiction of this action, pursuant to Rule 65(d) of the Federal Rules of Civil Procedure, for all purposes, including the implementation and enforcement of this order.

The Clerk of the Court is hereby directed to enter this Order pursuant to Rule 54(b) of the Federal Rules of Civil Procedure.

/s/
UNITED STATES DISTRICT COURT JUDGE

DATED: **SEP 30 1997**

APPENDIX E.

150 F.3d 675
Fed. Sec. L. Rep. P 90,252
(Cite as: 150 F.3d 675)

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee,
v.
Steven R. JAKUBOWSKI, Defendant-Appellant.

No. 97-4010.

United States Court of Appeals,
Seventh Circuit.

Argued May 19, 1998.

Decided July 16, 1998.

Securities and Exchange Commission (SEC) brought securities fraud case against attorney. The United States District Court for the Northern District of Illinois, Ann Claire Williams, J., 1997 WL 156544, granted summary judgment for SEC, and attorney appealed. The Court of Appeals, Easterbrook, Circuit Judge, held that: (1) defendant's false statements were made "in connection with" sale of securities; (2) false statements were material; and (3) defendant acted with scienter.

Affirmed.

*676 Susan S. McDonald (argued), Catherine A. Broderick, Securities & Exchange Commission, Office of the General Counsel, Washington, DC, for Plaintiff-Appellee.

Christopher J. Barber (argued), Rudnick & Wolfe, Chicago, IL, for Defendant- Appellant.

Before CUDAHY, EASTERBROOK, and DIANE P. WOOD, Circuit Judges.

EASTERBROOK, Circuit Judge.

Steven Jakubowski, a bankruptcy lawyer at Skadden Arps Slate Meagher & Flom, decided to make some money on the side by lining up stock from savings associations that were abandoning the mutual form. From this endeavor he reaped only $51,500, substantially less than his income from practicing law. The risk-return ratio was unfavorable. These dealings led to his discharge from the law firm, his suspension from the practice of law for 18 months, and a judgment (in this case) that he committed securities fraud. The district court enjoined Jakubowski from further securities offenses and ordered him to pay double his profits from the scheme, plus prejudgment interest. 912 F.Supp. 1073 (1996), 1997 U.S. Dist. Lexis 4000, 1997 U.S. Dist. Lexis 14575.

When a financial intermediary such as a savings and loan association is organized as a *677 mutual, the depositors nominally own its net worth. Because a mutual lacks formal equity and can issue only debt, it may encounter trouble raising money--and federal bank regulators want financial institutions to generate capital in order to reduce the risk born by the deposit insurance funds. Because financial insti-

tutions owned in stock form tend to take additional risk (widespread owners can diversify better), see Lawrence R. Cordell, Gregor D. McDonald & Mark E. Wohar, Corporate Ownership and the Thrift Crisis, 36 J.L. & Econ. 719 (1993), regulators seek to ensure that conversion from mutual to stock form is accompanied by the injection of substantial new money. But the managers of mutual S & Ls have the opposite incentive. By issuing stock at a low price, they can appropriate much of the S & L's net worth for themselves. Suppose a S & L with $200 million in assets has a net worth of $10 million. The managers could take the firm public by issuing one million shares at $10 per share. After the sale the firm would have a net worth of $20 million, and with one million shares in circulation each would trade for $20. The "original issue discount" of $10 per share would accrue to the initial buyers, among whom managers could figure prominently. Seeking to give managers an incentive to take their S & Ls public at higher prices (and thus lower original issue discounts), and to share any remaining discounts with the depositors, the Office of Thrift Supervision promulgated 12 C.F.R. § 563b.3, which among other things limits managers' ability to invest when a mutual converts to stock form and gives each account holder a right to purchase some of the stock. For descriptions of this regulation and its background, see Ordower v. OTS, 999 F.2d 1183 (7th Cir.1993), and Charter Federal Savings & Loan Association v. OTS, 912 F.2d 1569, 1570-76 (11th Cir.1990). To prevent managers and their friends from buying the account holders' subscription rights for a pittance, § 563b.3(i) makes the rights nontransferable. (Account holders might sell for too little because they would not appreciate the bargain element built into the original issue discount. Because conversion marks the initial public offering of stock, the account holders lack

the protection of an established market price. Documents prepared in connection with an initial offering take a pessimistic view of the offering's prospects in order to curtail liability under the Securities Act of 1933, and unsophisticated offerees therefore may not appreciate the bargain being offered. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975), provides an example.) The regulation provides:

> Acquisition of the securities of converting and converted savings associations--
> (1) Prior to the completion of a conversion, no person shall transfer, or enter into any agreement or understanding to transfer, the legal or beneficial ownership of conversion subscription rights, or the underlying securities to the account of another.
> (2) Prior to the completion of a conversion, no person shall make any offer, or any announcement of an offer, for any security of the converting savings association issued in connection with the conversion nor shall any person knowingly acquire securities of the converted savings association issued in connection with the conversion in excess of the maximum purchase limitations established in the association's approved plan of conversion pursuant to paragraph (c)(7) or (d)(4) of this section.

Like many a regulation, this one relies on broad application to thwart evasion. As written, § 563b.3(i) goes beyond arrangements between managers and depositors and forbids any third-party acquisition of depositors' subscription rights and executory contracts to purchase subscribers' shares when issued. This makes it hard for managers to acquire stock

through nominees, at the expense of reducing market opportunities for the depositors. It is this regulation that Jakubowski set out to evade.

In May 1991 Jakubowski received a call from Frank E. Hart, president of Generation Capital Associates, a venture capital firm. Hart told Jakubowski that Cragin Federal Bank for Savings was converting from mutual to stock form and asked Jakubowski to find a depositor eligible to purchase its stock, which Hart estimated carried an original issue ***678** discount of $3 per share. Hart offered to supply the capital necessary to buy as much stock as Jakubowski could find, paying Jakubowski 3.5% of any profit as a commission--but Hart's profit depended on lining up the stock before it was issued, for afterward the initial buyers then could sell to the market (reaping the original issue discount) rather than to Hart. Jakubowski was authorized to offer a 10% cut of Hart's profit to depositors eligible to purchase the stock, with Hart to bear all risk of loss. Jakubowski found a secretary at his law firm eligible to purchase stock in the Cragin offering, and she agreed to let Jakubowski use her subscription rights in exchange for 6.75% of the profits (increasing Jakubowski's take from 3.5% to 6.75%). The secretary gave Jakubowski an order form, which he filled out in her name with a request for 35,000 shares. The form instructed Cragin to send the shares to Jakubowski at Skadden Arps, as if he were the secretary's lawyer or trustee. Hart supplied the money. Jakubowski had the secretary sign the stock subscription form plus two documents that Cragin never saw--a stock power assigning ownership of the stock to Generation Capital Associates; and a contract awarding 6.75% of any eventual profit to the secretary. Cragin issued the stock as requested for $10 per share; trading after the conversion

opened at $13.50 per share, and Hart sold the 35,000 shares at an average price of $14 per share. Generation Capital Associates paid $10,073 to each of Jakubowski and the secretary. Jakubowski engaged in several similar transactions over the next year, taking the initiative to espy converting S & Ls and receiving a larger cut of the profits as a reward. The last came in March 1992, when Calumet Federal Savings and Loan Association converted. One of the Calumet depositors Jakubowski located was the sister of Lynn McGovern, a lawyer in Skadden Arps' banking group. When McGovern learned that Jakubowski was trying to persuade her sister to let him use her subscription rights, McGovern reminded Jakubowski that an order could be placed only for the account of the depositor. At approximately the same time an officer of one converting S & L visited a depositor with whom Jakubowski was dealing and warned the depositor that he could not sell his subscription rights; the depositor relayed this warning to Jakubowski--whose response to McGovern's advice and the officer's warning was to create documents purporting to show that the account holders were buying the stock themselves with borrowed money.

The form Jakubowski submitted to Cragin in the secretary's name provided, directly above the signature line:

> All rights exercisable hereunder are not transferable and shares purchased upon exercise of such rights must be purchased for the account of the person exercising such rights.

The prospectus for the offering contained a similar but much longer restriction. All of the stockpurchase forms Jakubowski completed during the year he worked with Hart

had functionally identical language; 10 of the 12 added that the depositors could not make agreements to sell the shares either. By filling out the form and procuring the secretary's signature, and adding his own name as the person to whom the stock should be sent, Jakubowski represented that this statement was true. But it was not. The stock was being purchased for the account of Generation Capital Associates, not of the secretary. Whether this transaction is best characterized as a transfer of the secretary's subscription rights, and thus a violation of § 563b.3(i)(1), as a pre- issuance offer to buy the secretary's stock, in violation of § 563b.3(i)(2), as both, or even (as Jakubowski insists) as neither, does not matter, for the OTS is not the plaintiff and § 563b.3 is not the fulcrum of the suit. The plaintiff is the Securities and Exchange Commission, and the regulation Jakubowski violated is 17 C.F.R. § 240. 10b-5, the ubiquitous Rule 10b-5. Section 563b.3(i) is why the savings associations required purchasers to certify that they had not transferred their subscription rights or agreed to transfer the shares themselves. Rule 10b-5(b), which forbids a purchaser of securities "[t]o make any untrue statement of a material fact", catches Jakubowski's false representations on the forms. The district court granted judgment to the SEC after concluding that any reasonable trier of fact would be compelled ***679** to find that these representations were made in connection with the issuance of securities, that the S & Ls would not have issued the stock had they known the truth about their beneficial ownership (hence that the lies were material), and that Jakubowski acted with scienter. He argues on appeal that each step of the district court's reasoning is mistaken.

[1] Let us start with the requirement that the false statement be "in connection with the purchase or sale of any secu-

rity"--language from § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), which authorized the SEC to promulgate Rule 10b-5. See generally Blue Chip Stamps; Isquith v. Caremark International, Inc., 136 F.3d 531 (7th Cir.1998). Jakubowski made his statements directly to the issuer of securities, in order to induce the issuer to accept his offer to buy. The offer was accepted and the shares issued. How could there be a closer "connection" between statements and "the purchase or sale of any security"? Jakubowski does not deny this factual link; instead he relies on Gurwara v. LyphoMed, Inc., 937 F.2d 380 (7th Cir.1991), for the proposition that the required "connection" is missing unless the misrepresentation concerns the value of the stock. This sounds more like an argument about materiality than about the "connection" between misrepresentation and the purchase or sale of securities, but never mind; this argument does not fit in either cubbyhole.

Gurwara attempted to exercise a stock option issued by his employer, which responded that he was no longer eligible to do so, having taken part-time status on account of disability. He sued under Rule 10b-5, contending that he had been inveigled into disqualifying himself from exercising the options. We held that the statements made to Gurwara concerning his status as an employee were not "in connection with the purchase or sale of any security' even though they turned out to have adverse consequences with respect to the options. Gurwara was foreordained by Blue Chip Stamps, which held that a misrepresentation that induces a decision not to purchase securities is outside the scope of § 10(b) and Rule 10b-5. Whether or not LyphoMed's statements amounted to fraud, cf. Jordan v. Duff & Phelps, Inc., 815 F.2d 429 (7th Cir.1987), any fraud could not have been "in connection

with the purchase or sale of any security" because neither a purchase nor a sale ensued. In both Blue Chip Stamps and Gurwara stock had a bargain element that eluded a potential purchaser because of a deceit, which fell outside Rule 10b-5 because there was no sale. Here, too, stock was offered with a bargain element, which eluded some potential purchasers because Jakubowski mopped up the supply of shares and reduced the number allocated to depositors. Today's case is a variation on Blue Chip Stamps, with the difference that instead of the beneficiaries of the bargain offer being talked out of purchasing, persons who were excluded from the bargain offer used deceit to secure some of the stock. That is an actual sale. True enough, we wrote in Gurwara that the "misrepresentation went only to Gurwara's opportunity to purchase the stock at the described price. It in no way related to the value of that stock." 937 F.2d at 382. But this passage was irrelevant to the question whether the statements were "in connection with" a (nonexistent) purchase or sale. Dicta cannot control over the language of the statute.

If a misrepresentation must concern the value of the security in order to meet the "connection" requirement, then United States v. O'Hagan, --- U.S ----, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997), and United States v. Naftalin, 441 U.S. 768, 99 S.Ct. 2077, 60 L.Ed.2d 624 (1979), were wrongly decided. O'Hagan, a lawyer, used information about an impending tender offer to purchase the target's stock (and call options for its stock) in advance of the bid's announcement. The Court held that this violated Rule 10b-5 (and satisfied the "connection" requirement) because it misappropriated the bidder's property rights in information about the impending offer. --- U.S. at ---- - ----, 117 S. Ct. at 2209-11. Although O'Hagan had private information about the future price of

the stock, he did not deceive the investors by trading at the market price; the bidder likewise could have purchased stock at the going price without violating Rule 10b-5. O'Hagan's actions wronged the bidder, ***680** not the persons from whom he bought stock; and as both the bidder and O'Hagan knew the details about the current and future prices of the stock, his acts did not relate to the value of the stock. The Court rejected an argument that would have limited Rule 10b-5's scope to frauds on other traders in the market and remarked that the statute "requires deception 'in connection with the purchase or sale of any security,' not deception of an identifiable purchaser or seller." --- U.S. at ----, 117 S.Ct. at 2210. O'Hagan's acts affected who would receive the increase in price: O'Hagan filched an element of value that belonged to someone else, just as Jakubowski diverted to himself (and Hart) an element of value that depositors otherwise would have realized. Then there is Naftalin, a case under § 17 of the 1933 Act, 15 U.S.C. § 77q, which requires proof that the fraud occurred "in" an offer or sale of securities--a tighter link, one might suppose, than "in connection with". Naftalin instructed a broker to sell stock short for his account, incorrectly representing that he owned enough stock to cover the sale. Actually the sale was a "naked short"; Naftalin neither owned nor borrowed enough stock to deliver on demand, which not only violated exchange rules but also greatly increased the broker's risk of nonpayment if the price of the stock should rise in the market. The Court held in Naftalin that a customer's misrepresentation about whether he owns enough stock to cover a short sale violates § 17. Such a representation has nothing to do with the value of the stock; it concerns only who (as between customer and broker) bears the risk of future market movements. If a misrepresentation about ownership of shares is "in" the sale of stock, then

Jakubowski's misrepresentation about who was buying the shares was "in connection with" the sale of stock.

Many of this court's cases say that a misrepresentation can be "in connection with" the purchase or sale of securities only if it influences an investment decision. E.g., Isquith, 136 F.3d at 534-36; LHLC Corp. v. Cluett, Peabody & Co., 842 F.2d 928, 931-32 (7th Cir.1988); Harris Trust & Savings Bank v. Ellis, 810 F.2d 700, 704 (7th Cir. 1987). Suppose a misrepresentation in connection with a corporate merger lulls the investor into foregoing an opportunity to file suit in state court charging the managers with violating their fiduciary duties. There may be a causal connection between the misrepresentation and a securities transaction; had suit been filed, the merger might not have occurred, and the exchange of securities that occurs in a merger--which can amount to a "sale"--also would have been averted. Goldberg v. Meridor, 567 F.2d 209, 218-21 (2d Cir.1977), holds that this sort of connection between the misrepresentation and a securities transaction satisfies § 10(b) and Rule 10b-5. LHLC and Isquith reject Goldberg, the forced-seller doctrine, and the fundamental-change doctrine, and insist that the wrongdoing affect an investment decision (as opposed to a litigation decision or an election to give the stock to one's children), in order to implement the holding of Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 97 S.Ct. 1292, 51 L.Ed.2d 480 (1977), that corporate mismanagement and similar wrongs do not violate Rule 10b-5 even though they may affect the price at which securities trade. But to say, as our cases do, that only investment decisions come within Rule 10b-5 is not to impose a further requirement that the wrong affect the price of the stock. That requirement would be unrelated to Santa Fe and would conflict with O'Hagan and Naftalin. Jakubowski

and Hart made investment decisions when they purchased the stock issued by the converting S & Ls; their profits depended on reselling the securities they purchased; that they viewed these investments as sure things does not differentiate them from O'Hagan.

[2] What we have said about the "connection' requirement suffices to establish materiality as well. The S & Ls would not have issued the stock had they known the identities of the real purchasers. Some proved this point by examining the applications, concluding that the proposed purchases were excessive in relation to the assets of the depositors in whose names Jakubowski had submitted applications to purchase stock, and contacting these depositors to inform them that a transfer of subscription rights was forbidden. At least two depositors withdrew ***681** from the scheme as a result. Jakubowski's response?: he increased the purchases made in the names of other depositors that the S & Ls did not suspect of selling their subscription rights. To the extent Kolder v. Kohler Co., 319 F.2d 634, 638 (7th Cir.1963), suggests that only statements concerning the value of a security can be "material" for purposes of federal securities law, it did not survive O'Hagan and Naftalin. The definition of "materiality" in TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976), and Basic, Inc. v. Levinson, 485 U.S. 224, 232, 108 S.Ct. 978, 99 L.Ed.2d 194, (1988), covers whatever is important enough to reasonable participants in an investment decision to alter their behavior. Usually price (or facts that influence price) is all that matters to securities transactions, but Rule 10b-5 does not foreclose the possibility that the participants will deem other facts vital. Close corporations often adopt provisions restricting equity ownership to employees and their families, and evasion of these limits could be highly material to the venture. In

Blue Chip Stamps a judicial decree provided that the victorious plaintiffs in a class action would be compensated in discount stock rather than cash; again a deceit that enabled a non-member of the class to obtain some of the stock would have been material. Just so here. At the insistence of the OTS, the S & Ls made the identity of the purchaser a sine qua non in these transactions.

[3] Last comes the question of scienter. Under Ernst & Ernst v. Hochfelder, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976), and Aaron v. SEC, 446 U.S. 680, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980), only persons who act with an intent to deceive or manipulate violate Rule lOb-5. Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1044-45 (7th Cir.1977), holds that reckless disregard of the truth counts as intent for this purpose. Jakubowski depicts himself as a bankruptcy lawyer too wrapped up in handling major corporate reorganizations to be concerned about the minutiae of the S & Ls' offerings. How was he to learn about § 563b.3(i)(1) or qualifications on page 105 of some windy prospectus? Perhaps he was careless, Jakubowski allows, but he contends that a jury could conclude that he neither intentionally nor recklessly misstated any fact to the issuers-if not for all of the offerings, then for some. He adds that the Cragin purchase form did not explicitly forbid agreements to resell the stock, and that after reading this form and concluding that his conduct was proper, he didn't bother to read language in the other forms that would have alerted him to the problem. Careless again, Jakubowski allows, but not intentionally deceptive. The district judge patiently covered the details of the dozen transactions; it is enough to say that we agree with her decision and indicate the principal reasons why-reasons applicable to all transactions even on the as-

sumption that Jakubowski did not read through the documents in his hands.

First, all of the forms Jakubowski completed explicitly stated that subscription rights could not be transferred, and all but two explicitly stated that depositors could not enter into preissuance agreements to resell shares they received. Reading these forms, and the prospectuses for the other two, did not require legal research. Over and again we say that people claiming to be victims of securities fraud may not claim to rely on oral statements inconsistent with written documents (even tedious prospectuses) available to them. E.g., Carr v. CIGNA Securities, Inc., 95 F.3d 544 (7th Cir.1996); Eckstein v. Balcor Film Investors, 8 F.3d 1121 (7th Cir.1993); Teamsters Local 282 Pension Trust Fund v. Angeles, 762 F.2d 522, 529-30 (7th Cir.1985); see also Jackvony v. RIHT Financial Corp., 873 F.2d 411 (1st Cir.1989) (Breyer, J.). That is no less true when the person claiming ignorance of the writing made rather than received misstatements; for a lawyer to fail to read a document central to a business transaction is reckless indeed. Jakabowski also did not take any of the steps that would have been appropriate to a securities transaction at Skadden Arps. He says that a quick LEXIS search did not turn up any cases condemning his chosen strategy, but he did not look for statutes or regulations--and, more to the point, he did not mention what he was doing to any banking or securities lawyer, let alone seek the opinion of a specialist. Deliberate ignorance, ***682** the description of Jakubowski's mental state most favorable to him, is a form of knowledge. See United States v. Ramsey, 785 F.2d 184 (7th Cir. 1986).

Second, the fact that Jakubowski was paid $50,000 for locating 12 holders of deposit accounts at S & Ls was enough by itself to put him on notice that something was amiss. Why did Jakubowski think that Hart was paying for depositors' names and subscription forms? Why, indeed, were forms being submitted in depositors' names? if subscription rights were transferable, then Hart could have obtained depositor lists from the S & Ls or placed an ad in the paper, and the purchase applications would have been submitted in the name of Generation Capital Associates. A secondary market in subscription rights would have developed, providing depositors with a greater portion of the anticipated gains. Jakubowski has no explanation, consistent with genuine belief in their propriety, for the structure of these transactions.

Third, Jakubowski received notice from at least two S & Ls, plus another lawyer at Skadden Arps, that depositors could not transfer their subscription rights. His response was to reroute purchases through the accounts of depositors whose applications the banks had not identified as suspicious and to create bogus documents to cover his trail. These steps yield irrefutable evidence of intent to deceive. In the Calumet transaction, for example, Jakubowski prepared papers purporting to show that Generation Capital Associates was loaning money to the depositors so that they could purchase the shares for their own accounts. The documents were fictions, no money was loaned; the depositors never received the shares and took no risk of loss (and stood to reap only small fractions of any gain). The documents did not state the duration of the loans or the rates of interest to be paid, for such details were irrelevant given the absence of an extension of credit. Adding icing to the cake, Jakubowski back-

dated some of these documents so that it would appear that the "loans" preceded the banks' inquiries.

What there is to be said on Jakubowski's behalf-that he was busy, that he was not a securities or banking lawyer, and so on--could not persuade a reasonable trier of fact on any of the disputed questions. Summary judgment therefore was in order and is

AFFIRMED.

APPENDIX F.

SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934

15 U.S.C. § 78j(b)

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange— . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

APPENDIX G.

RULE 10b-5 OF THE SECURITIES AND EXCHANGE COMMISSION

17 C.F.R. § 240.10b.5

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

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No. 98-643

In the Supreme Court of the United States

OCTOBER TERM, 1998

STEVEN R. JAKUBOWSKI, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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QUESTION PRESENTED

Whether a misrepresentation, which induces the sale of securities but does not pertain to the securities themselves or the consideration offered in exchange for the securities, is made "in connection with the purchase or sale" of the securities for purposes of establishing liability under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	6
Conclusion	15

TABLE OF AUTHORITIES

Cases:

Abrams v. *Oppenheimer Government Securities, Inc.*, 737 F.2d 582 (7th Cir. 1984)	8
Angelastro v. *Prudential-Bache Securities, Inc.*, 764 F.2d 939 (3d Cir.), cert. denied, 474 U.S. 935 (1985)	10-11
Arrington v. *Merrill Lynch, Pierce, Fenner & Smith Inc.*, 651 F.2d 615 (9th Cir. 1981)	11
A.T. Brod & Co. v. *Perlow*, 375 F.2d 393 (2d Cir. 1967)	7, 9
Blue Chip Stamps v. *Manor Drug Stores*, 421 U.S. 723 (1975)	8, 10
Brown v. *Ivie*, 661 F.2d 62 (5th Cir. 1981)	8, 10
Central Bank of Denver, N.A. v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994)	7
Chemical Bank v. *Arthur Anderson & Co.*, 726 F.2d 930 (2d Cir.), cert. denied, 469 U.S. 884 (1984)	11
Chevron U.S.A. Inc. v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)	11, 12, 13
Competitive Associates, Inc. v. *Laventhol, Krekstein, Horwath & Horwath*, 516 F.2d 811 (2d Cir. 1975)	11
Ernst & Ernst v. *Hochfelder*, 425 U.S. 185 (1976)	6

Cases—Continued: Page

Gurwara v. *LymphoMed, Inc.*, 937 F.2d 380 (7th Cir. 1991) 6, 14, 15
Herman & MacLean v. *Huddleston*, 459 U.S. 375 (1983) 7
Hunt v. *Robinson*, 852 F.2d 786 (4th Cir. 1988) 14
Marbury Management, Inc. v. *Kohn*, 629 F.2d 705 (2d Cir.), cert. denied, 449 U.S.C. 1011 (1980) 10, 11
Ordower v. *OTS*, 999 F.2d 1183 (7th Cir. 1993) 3
Rand v. *Anaconda-Ericsson*, 794 F.2d 843 (2d Cir.), cert. denied, 479 U.S. 987 (1986) 8, 13, 14
Saxe v. *E.F. Hutton & Co.*, 789 F.2d 105 (2d Cir. 1986) 14
SEC v. *Blavin*, 760 F.2d 706 (6th Cir. 1985) 7
SEC v. *Drysdale Securities Corp.*, 785 F.2d 38 (2d Cir.), cert. denied, 476 U.S. 1171 (1986) 8, 13
SEC v. *First Jersey Securities*, 101 F.3d 1450 (2d Cir. 1996), cert. denied, 118 S. Ct. 57 (1997) 7
SEC v. *Rana Research, Inc.*, 8 F.3d 1358 (1993) 7
Superintendent of Insurance v. *Bankers Life & Casualty Co.*, 404 U.S. 6 (1971) 7, 8, 9
Thomas Jefferson Univ. v. *Shalala*, 512 U.S. 504 (1994) 11
United States v. *Naftalin*, 441 U.S. 768 (1979) 6, 9
United States v. *O'Hagan*, 117 S. Ct. 2199 (1997) 6, 9
Wisniewski v. *United States*, 353 U.S. 901 (1957) 15

Statutues, regulations and rule:

Securities Act of 1933, § 17(a), 15 U.S.C. 77q(a) 10
Securities Exchange Act of 1934, § 10(b), 15 U.S.C. 78j(b) 2, 5, 6, 7, 8, 9, 10, 11, 12, 13
12 C.F.R.:
Section 563b.2(a)(15) 2
Section 563b.3(c)(2) 2
Section 563b.3(c)(5) 2
Section 563b.3(c)(6) 2
Section 563b.3(c)(14) 2

Regulations and rule—Continued: Page

Section 563b.3(i)(1) 3
Section 563b.7(g)(4)(ix) 3
17 C.F.R. 240.10b-5 ..... 2, 5, 6, 7, 8, 9, 11

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BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 71a-86a) is reported at 150 F.3d 675. The opinion and order of the district court denying defendant's motion to dismiss (Pet. App. 1a-32a) is reported at 912 F. Supp. 1073. The district court's opinion and order granting plaintiff's motion for summary judgment (Pet. App. 33a-57a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on July 16, 1998. The petition for a writ of certiorari was filed on October 14, 1998. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

During 1991 and 1992, petitioner, an associate in the law firm of Skadden Arps Slate Meagher & Flom, engaged in a fraudulent scheme to buy the stock of savings and loan institutions (S&Ls) that he was not eligible to purchase by submitting orders in the names of deposit account holders who were. In this civil enforcement action brought by respondent Securities and Exchange Commission (SEC or Commission), the court of appeals affirmed the district court's entry of summary judgment against petitioner for violating the anti-fraud provisions of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, a rule that the SEC has promulgated to implement the statutory provision, which it is charged to administer.

1. Under regulations issued by the Office of Thrift Supervision (OTS), federally chartered S&Ls are permitted to convert from mutual to stock ownership and to sell stock in connection with the conversion. Deposit account holders of converting S&Ls are given subscription rights to purchase conversion stock before any is offered to the general public. Only those securities remaining after the close of the subscription offering may be offered to the public. 12 C.F.R. 563b.3(c)(2), (5) and (6). In order to be eligible for subscription rights, an account holder must have maintained an account with a specified minimum balance for a specified period of time before the S&L's board of directors adopted the conversion plan. 12 C.F.R. 563b.2(a)(15), 563b.3(c)(14). OTS regulations also prohibit transfer of subscription rights or the underlying conversion stock prior to consummation of the conversion and require notice of that

restriction on stock order forms. 12 C.F.R. 563b.3(i)(1), 563.b.7(g)(4)(ix).

The regulations prevent dilution of the ownership interests of long-term depositors and prevent "persons who get wind of the plan from granting themselves priority in the purchase of stock by enlarging their accounts or opening new ones." *Ordower* v. *OTS*, 999 F.2d 1183, 1185-1186 (7th Cir. 1993). During 1991 and 1992, the stock of newly converted institutions routinely increased in price upon the opening of public trading. Account holders who exercised their subscription rights could therefore usually earn a quick profit by immediately reselling their shares to the public. See *id.* at 1185.

2. As non-account holders, petitioner and his business associate Frank Hart were ineligible to purchase conversion stock. Pet. App. 3a, 5a. To circumvent the eligibility requirement and to capture the profits that OTS regulations intended to confine to account holders, petitioner (initially at Hart's request and later on his own initiative) located eligible account holders and offered them a percentage of profits from sale of the stock in exchange for use of their subscription rights. *Id.* at 34a-40a, 75a-76a. Petitioner prepared subscription forms in the names of the account holders, specified on the forms that the stock certificates be sent to him at his law firm, and had the account holders sign the forms. *Id.* at 35a-39a, 75a.

Between May 1991 and March 1992, petitioner submitted twelve stock order forms to four savings and loan associations. Pet App. 34a-40a. Hart (and, in one instance, a friend of petitioner's) furnished the funds needed to exercise the subscription rights. *Id.* at 35a-39a, 75a. In one conversion, petitioner placed an order for 100,000 shares at a total cost of $1,127,000. *Id.* at

39a. For his participation in the scheme, petitioner received a percentage of the profits when Hart sold the stock. *Id.* at 75a-76a.

As required by OTS regulations, the subscription forms that petitioner filled out prominently stated that the account holder's subscription rights were non-transferable. Pet. App. 75a-76a. Moreover, the forms required the account holders to certify that they had not entered into any agreement to transfer either the subscription rights or the shares they were ordering. *Id.* at 5a-6a, 77a. The certifications on the forms petitioner filled out were false. *Id.* at 77a.

At least two of the applications petitioner submitted were questioned by the S&Ls. Pet. App. 38a, 51a-52a, 76a. S&L officers warned the account holders in whose names the orders had been submitted that they were prohibited from selling their subscription rights. *Id.* at 76a. When the account holders related the warnings to petitioner, he did not withdraw the orders. *Id.* at 40a. Petitioner thereafter created and backdated false loan documents purporting to show loans extended by Hart to the account holders. *Id.* at 76a, 85a-86a.

In all, petitioner and Hart used account holders' subscription rights to purchase 172,050 shares of stock in four different conversions for a total purchase price of almost $2 million. Pet. App. 7a. Petitioner received $51,500 as his share of the profits. *Id.* at 72a. Because there was only a limited amount of conversion stock issued by each savings and loan and the offerings were oversubscribed, some account holders were not permitted to buy as much stock as they had ordered. *Id.* at 4a, 6a-7a. Thus, petitioner's fraudulent purchase of $2 million of conversion stock for himself and Hart deprived legitimate subscribers of the opportunity to

purchase and profit from the sale of stock they otherwise would have been allotted.

3. a. After denying petitioner's motion to dismiss the complaint for failure to state a claim, Pet. App. 1a-32a, the district court granted the Commission's motion for summary judgment, *id.* at 33a-57a. The court found that petitioner had raised no genuine issue of material fact with regard to any of the elements of the Commission's claims under Section 10(b) and Rule 10b-5. *Id.* at 45a.

The court rejected petitioner's argument that the requirement of Section 10(b) and Rule 10b-5 that the fraud be "in connection with the purchase or sale of any security" was not met because his deception did not relate to the value of the securities. Pet. App. 52a. That requirement was met, the court found, because petitioner's concealment of the purchasers' identities was the very means by which petitioner and his associates succeeded in purchasing securities that they were legally prohibited from purchasing. *Ibid.* (incorporating reasoning of opinion denying motion to dismiss, *id.* at 24a-29a).

The district court therefore entered final judgment against petitioner. The court permanently enjoined petitioner from further violations of Section 10(b) and Rule 10b-5, ordered him to disgorge illegal profits in the amount of $51,500 and to pay prejudgment interest of $26,922, and imposed a civil penalty of $51,500. Pet. App. 67a-70a.

b. The court of appeals affirmed. Pet. App. 71a-86a. As had the district court, the Seventh Circuit rejected petitioner's argument that his misrepresentations were not in connection with the purchase or sale of a security. *Id.* at 78a. The court explained:

> Jakubowski made his statements directly to the issuer of securities, in order to induce the issuer to accept his offer to buy. The offer was accepted and the shares issued. How could there be a closer "connection" between statements and "the purchase or sale of any security"?

Ibid. The court of appeals explained that its decision was not inconsistent with the court's earlier decision in *Gurwara* v. *LymphoMed, Inc.*, 937 F.2d 380 (7th Cir. 1991), because in that case, unlike this one, there was no purchase or sale of the securities at issue. Pet. App. 78a-79a. The court further noted that petitioner's argument that a misrepresentation must concern the value of a security in order to violate Section 10(b) and Rule 10b-5 was inconsistent with this Court's decisions in *United States* v. *O'Hagan*, 117 S.Ct. 2199 (1997), and *United States* v. *Naftalin*, 441 U.S. 768 (1979), neither of which involved such a misrepresentation. Pet. App. 79a-80a.[1]

ARGUMENT

The court of appeals correctly held that petitioner's misrepresentations were made in connection with the purchase or sale of securities. That decision does not conflict with the decision of any other court of appeals. This Court's review is therefore not warranted.

1. The Court has described Section 10(b) as "a 'catchall' clause to enable the Commission to 'deal with new manipulative (or cunning) devices.'" *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 203 (1976); accord

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[1] The court of appeals also rejected petitioner's contentions that his misrepresentations were not material and that he did not possess the requisite scienter. Pet App. 82a-86a. Petitioner has not renewed those challenges before this Court.

Herman & MacLean v. *Huddleston*, 459 U.S. 375, 386-387 (1983); *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 174 (1994). The statute and rule "prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception." *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 11 n.7 (1971) (quoting *A.T. Brod & Co.* v. *Perlow*, 375 F.2d 393, 397 (2d Cir. 1967)). In an enforcement action brought under Section 10(b) and Rule 10b-5, the Commission need establish only that, "in connection with the purchase or sale of a security the defendant, acting with scienter, made a material misrepresentation (or a material omission if the defendant had a duty to speak) or used a fraudulent device." *SEC* v. *First Jersey Securities, Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996), cert. denied, 118 S. Ct. 57 (1997).[2]

Petitioner nevertheless attempts to limit the scope of Section 10(b) and Rule 10b-5 by reading into the statute and rule a requirement that is not there. Petitioner contends (Pet. 3-4, 10-13, 17) that his misrepresentations were not "in connection with the purchase or sale of any security" within the meaning of Section 10(b) and Rule 10b-5 because they did not relate to the securities themselves or the consideration paid for the securities. At times he appears to go further and to argue (Pet. 7, 9, 12) that the misrepresentation must relate to the

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[2] Unlike a private plaintiff seeking to recover damages in a Section 10(b) action, the Commission is not required to show either reliance on the misrepresentation or injury. *SEC* v. *Rana Research, Inc.*, 8 F.3d 1358, 1364 (9th Cir. 1993); *SEC* v. *Blavin*, 760 F.2d 706, 711 (6th Cir. 1985).

value of the securities or consideration. But the statute and the rule contain no such restrictions.

By their terms, Section 10(b) and Rule 10b-5 apply to any fraud occurring "in connection with the purchase or sale of any security," or, as this Court paraphrased the requirement in *Bankers Life*, fraud "touching" the purchase or sale of a security. 404 U.S. at 12-13. The language should be given its plain meaning: The deception need only have some relationship or nexus to a securities transaction.

The courts of appeals have consistently given the "in connection with" requirement that plain meaning. For example, in *Rand* v. *Anaconda-Ericsson*, 794 F.2d 843, 847, cert. denied, 479 U.S. 987 (1986), the Second Circuit stated that the "in connection with" language requires only that the misrepresentations "have some direct pertinence to a securities transaction." Similarly, in *SEC* v. *Drysdale Securities Corp.*, 785 F.2d 38, 42-43 (2d Cir.), cert. denied, 476 U.S. 1171 (1986), the court held that the "in connection with" requirement was met when "securities were transferred as a direct result" of the misrepresentation. See also *Abrams* v. *Oppenheimer Government Securities, Inc.*, 737 F.2d 582, 593 (7th Cir. 1984) ("the 'in connection with' requirement amounts to some nexus but not necessarily a direct and close relationship"); *Brown* v. *Ivie*, 661 F.2d 62, 65 (5th Cir. 1981) ("'in connection with' is to be flexibly applied but requires that there be a nexus between the defendant's fraud and the securities 'sale'").

There is no requirement that the fraud concern an aspect of the security itself, such as its value, or the consideration paid for it. "Neither § 10(b) nor Rule 10b-5 contains any language which would indicate that these provisions were intended to deal only with fraud as to the 'investment value' of securities, and, indeed, it

is established that a 10b-5 action will survive even though the fraudulent scheme or device is unrelated to 'investment value.'" *A. T. Brod & Co.*, 375 F.2d at 396-397. In short, the "in connection with" language of Section 10(b) and Rule 10b-5 imposes a requirement of a nexus between the deception and a securities transaction, not a restriction on the subject matter of a fraudulent misrepresentation or omission.

This Court has held actionable under Section 10(b) fraud that concerns neither the value of the securities nor the amount of consideration paid for them. Recently, in *O'Hagan*, 117 S. Ct. at 2209, the Court held that the "in connection with" requirement was met because a misrepresentation of loyalty and confidentiality, made to a nonparticipant in the defendant's subsequent securities transactions, allowed the defendant to obtain confidential information that he used to purchase stock in a company targeted for takeover. The misrepresentation in *O'Hagan* was "feigning fidelity to the source of the information." *Ibid.* Thus, contrary to petitioner's contention (Pet. 18.), the misrepresentation in *O'Hagan* did not relate to the price of the securities.

In *Bankers Life*, 404 U.S. at 9-10, this Court found the "in connection with" requirement met even though "the full market price was paid for" the securities sold, because "the seller [corporation] was duped into believing that it, the seller, would receive the proceeds" when, in fact, the defendant corporate insiders misappropriated the proceeds. That misrepresentation thus concerned the identity of the entity that would receive the proceeds of the sale of securities rather than the value of the securities sold or the consideration paid. Finally, in *Naftalin*, *supra*, the Court held that the defendant's misrepresentation that he owned the stock

he sold when in fact he sold it "short" violated Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), a provision analogous to Section 10(b) that prohibits fraud "in the offer or sale" of a security.

The courts of appeals have repeatedly held that Section 10(b) applies to fraud that does not involve misrepresentations about the securities themselves or the consideration paid for them. In *Marbury Management, Inc.* v. *Kohn*, 629 F.2d 705, 707, cert. denied, 449 U.S. 1011 (1980), the Second Circuit found that a brokerage firm trainee's misrepresentation that he was an experienced stockbroker and "portfolio management specialist" was actionable under Section 10(b) because the "misstatements of his status not only induced the purchase of the securities involved but their retention as investments as well." The court stated that limiting coverage to misrepresentations relating to the value of securities "would be too accommodative of many common types of fraud, such as the misrepresentation of a collateral fact that induces a transaction." *Id.* at 710 n.3.

Similarly, other courts of appeals have interpreted the "in connection with" clause to require only a nexus with a securities transaction and not a misrepresentation about the securities involved or the consideration paid. For example, in *Brown*, *supra*, the Fifth Circuit held that the "in connection with" requirement was met because the defendants' false representation about insurance requirements induced the plaintiff to sign an agreement that he would sell his stock at book value if he was no longer employed by the company, 661 F.2d at 64-65. The misrepresentation in the case concerned the reason for signing the agreement but did not concern the characteristics of the stock or the price to be paid. See *id.* at 64 & n.3. And, in *Angelastro* v.

Prudential-Bache Securities, Inc., 764 F.2d 939, 944-945, cert. denied, 474 U.S. 935 (1985), the Third Circuit held that a broker-dealer's failure to disclose the interest rates on a margin account was actionable under Section 10(b) and Rule 10b-5 even though it did "not affect the investment value of a particular security," because it "induced [the plaintiff] to purchase certain securities to her financial detriment."

If the "in connection with" clause were construed as petitioner advocates, the protection that Congress provided investors through Section 10(b) would be unduly limited. Investors would be unprotected in situations like those described above, which the courts have long regarded as covered by the statute. The curtailment of protection would be particularly pronounced in the broker-dealer context, in which fraud on customers often involves misrepresentations about the qualifications of salespersons, the risks of margin trading, the qualifications of the brokerage firm, or similar matters that do not pertain to the securities bought or sold or the consideration paid for those securities. See, *e.g.*, *Marbury Management*, 629 F.2d at 707; *Arrington* v. *Merrill Lynch, Pierce, Fenner & Smith Inc.*, 651 F.2d 615, 619 (9th Cir. 1981) (misrepresentation of risks of buying securities on margin); *Competitive Associates, Inc.* v. *Laventhol, Krekstein, Horwath & Horwath*, 516 F.2d 811, 812-813 (2d Cir. 1975) (misrepresentations about a financial adviser's performance).[3]

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[3] If there were any question about the proper interpretation of Section 10(b) or Rule 10b-5, the Court should defer to the reasonable interpretation of the SEC, which administers the statute and promulgated the rule. See *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-844 (1984); *Thomas Jefferson Univ.* v. *Shalala*, 512 U.S. 504, 512 (1994).

2. Contrary to petitioner's contention (Pet. 10-15), there is no conflict among the courts of appeals on the issue petitioner presents.[4] In this case, petitioner's misrepresentations had a particularly close nexus with securities transactions—they directly induced those transactions. In contrast, any misrepresentations in the cases on which petitioner relies did not have that nexus.

In *Chemical Bank* v. *Arthur Andersen & Co.*, 726 F.2d 930 (2d Cir.), cert. denied, 469 U.S. 884 (1984), upon which petitioner principally relies (Pet. 11-12, 15), the misrepresentation (that the borrower was solvent) induced not a transfer of securities but a loan evidenced by notes that the court held (726 F.2d at 936-939) were not securities. The loan was secured by the pledge of stock. The court agreed that the pledge was a purchase or sale of securities but held that the misrepresentation was in connection with the loan, not the pledge, which "was merely an incident in a transaction not otherwise involving the purchase or sale of securities." *Id.* at 944 n.24. The court explained that the "Act and Rule impose liability for a proscribed act in connection with the purchase or sale of a security; it is not sufficient to allege that a defendant has committed a proscribed act in a transaction of which the pledge of a security is a part." *Id.* at 943. Accordingly, although the court stated (*ibid.*) that it was deciding in the negative the question whether misrepresentations or omissions "not pertaining to the securities themselves" can form the basis of a violation of Section 10(b), that was not the holding of the case. Rather, the court held only that the misrepresentations must pertain to the securities

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[4] Petitioner's other reasons why the Court should grant certiorari (Pet. 15-17) all depend on the incorrect premise that there is a conflict among the courts of appeals.

transaction itself, not to a different transaction to which the securities transaction is related.[5]

The Second Circuit has made clear in subsequent decisions that *Chemical Bank* did not hold that the "in connection with" requirement restricts the subject matter of the misrepresentations that are actionable under Section 10(b). That court explained in *Drysdale Securities Corp.*, 785 F.2d at 42-43, that "in *Chemical Bank* the direct result of the misrepresentations was a loan and not a securities transfer," but that where, as in *Drysdale*, "securities *were* transferred as a direct result of the misrepresentation" (emphasis supplied), the "in connection with" requirement was met. Further, in *Rand*, 794 F.2d at 847, the Second Circuit emphasized that "none of the alleged misrepresentations [in *Chemical Bank*] pertained to the pledged securities and * * * the incidental involvement of securities as collateral did not by itself implicate the anti-fraud provisions of the federal securities laws." Although the court held that there was no Section 10(b) liability because there was no securities transaction, it described the "in connection with" language of Section 10(b) as requiring only that the "misrepresentations

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[5] Further, *Chemical Bank* was a private action in which the plaintiff, unlike the Commission in its enforcement actions, see note 2, *supra*, must show that it relied on the misrepresentation and that damage resulted from that reliance (elements that the Second Circuit refers to as "transaction causation" and "loss causation"). The language in the *Chemical Bank* decision that, according to petitioner (Pet. 11-12), holds that only misrepresentations about the security are actionable under Section 10(b), read in context, actually pertains to the elements of reliance and injury. See *Chemical Bank*, 726 F.2d at 943 n.23. As petitioner observes (Pet. 16), in private actions those elements may be closely related to—or even confused with—the "in connection with" requirement.

* * * have *some direct pertinence to a securities transaction.*" *Ibid.* (emphasis supplied).

In *Saxe* v. *E.F. Hutton & Co.*, 789 F.2d 105, 109 (2d Cir. 1986), which petitioner also contends conflicts with the decision in this case (Pet. 12), the alleged misrepresentations concerned a commodities firm with which the plaintiff opened an account to invest the proceeds from the sale of his securities. The court explained that "the link between the sale of those securities and the opening of the commodities account was too tenuous to satisfy the 'in connection with' requirement of Rule 10b-5," because the plaintiff had already decided to sell his securities *before* the misrepresentations. *Id.* at 108-109. Thus, unlike in this case, the misrepresentations did not induce a sale of securities. Notably, the court held that the plaintiff had stated a claim under the anti-fraud provisions of the Commodity Exchange Act, which requires deception "in connection with" commodities transactions, because the misrepresentations induced him to open the commodities account. *Id.* at 109.

In *Hunt* v. *Robinson*, 852 F.2d 786, 787 (4th Cir. 1988), also cited by petitioner (Pet. 3, 13, 17), the defendants refused to transfer company stock to the plaintiff as required by his employment contract. In finding no "causal connection" between the allegedly fraudulent refusal to transfer the stock and any actual sale of stock, the Fourth Circuit stated that a state law claim of "fraudulent nonconveyance of stock" is "not transformed into a federal claim simply because the object of the bargain was shares of stock." 852 F.2d at 787.

Finally, petitioner mistakenly contends (Pet. 4, 8-9, 13) that the decision in this case conflicts with the Seventh Circuit's earlier decision in *Gurwara*, *supra*.

Any such conflict would not warrant this Court's review. See *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957). In any event, as the court of appeals explained in this case (Pet. App. 79a), the plaintiff in *Gurwara* had no cause of action because there was no purchase or sale of the stock of the company that employed him, and that stock was "the 'security' on which his 10(b) action was based" (937 F.2d at 382 n.2).[6] Here, of course, petitioner's misrepresentations actually induced sales of securities.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[6] In *Gurwara*, the employer's false promise not to revoke the employee's stock option rights had induced the employee to take short-term disability leave. The court expressly declined to consider whether the employee "might have sued successfully under section 10(b) for misrepresentations in connection with his *option contract*." 937 F.2d at 382 n.2.